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No. ———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

WEBSTER A. COLLINS, HERBERT R. MORRISON, HELEN O. MORRISON, AND GLEN A. WILKINSON,
Petitioners,

v.

DAVID R. JOHNSTON, THE NORTHWESTERN BANK, AND JAMES R. GILLEY,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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QUESTION PRESENTED

Whether a reorganization trustee may, in order to relieve the debtor's estate of claims by defrauded investors, cooperate with those investors by paying their costs in a joint lawsuit asserting related claims against the debtor's former management and others charged with defrauding the debtor and its investors.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	iv
OPINIONS BELOW	1
JURISDICTIONAL STATEMENT	1
APPLICABLE STATUTES AND REGULATIONS	2
STATEMENT OF THE CASE	2
REASONS FOR GRANTING THE WRIT	8
I. THE DECISION OF THE COURT OF APPEALS RAISES AN IMPORTANT AND RECURRING QUESTION CONCERNING THE AUTHORITY OF THE TRUSTEE IN REORGANIZATION WHICH URGENTLY NEEDS RESOLUTION BY THIS COURT	8
II. REVIEW OF THE JUDGMENT BELOW IS REQUIRED TO RESOLVE THE CONFLICT BETWEEN CIRCUITS	18
CONCLUSION	20

PRECEDING PAGE WAS BLANK

TABLE OF AUTHORITIES

Cases	Page
American Employers' Insurance Co. v. *King Resources Co.*, 556 F.2d 471 (10th Cir. 1977)	13
In re Associated Gas & Electric Co., 149 F.2d 996 (2d Cir.), *cert. denied*, 326 U.S. 736 (1945)	13
Caplin v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972)	10, 14, 15, 16, 17
Carpenter v. *Hall*, 311 F. Supp. 1099 (S.D. Tex. 1970)	13
In re Credit Industrial Corp., 366 F.2d 402 (2d Cir. 1966)	13
Dietrich Corp. v. *King Resources Co.*, 583 F.2d 1143 (10th Cir. 1978)	13
Dorfman v. *First Boston Corp.*, Fed. Sec. L. Rep. (CCH) ¶ 94,155 (E.D. Pa. 1973)	13
In re Equity Funding Corp. of America, 519 F.2d 1274 (9th Cir. 1975)	12, 18
In re Equity Funding Corp. of America, 416 F. Supp. 132 (C.D. Cal. 1975)	12, 13, 17, 18
In re Farrington Manufacturing Co., 540 F.2d 653 (4th Cir. 1976)	13, 15
In re Four Seasons Nursing Centers of America, Inc., 472 F.2d 747 (10th Cir. 1973)	13
In re Four Seasons Nursing Centers of America, Inc., 357 F. Supp. 594 (W.D. Okla. 1973)	12, 18
Gilbert v. *Bagley*, 492 F. Supp. 714 (M.D.N.C. 1980)	14
Marrero v. *Abraham*, 473 F. Supp. 1271 (E.D. La. 1979)	16
McLean v. *Alexander*, 449 F. Supp. 1251 (D. Del. 1978), *rev'd on other grounds*, 599 F.2d 1190 (3d Cir. 1979)	16
Northwest Airlines, Inc. v. *Transport Workers Union*, 49 U.S.L.W. 3423 (U.S., argued Dec. 2, 1980) (No. 79-1056)	17
SEC v. *American Trailer Rentals Co.*, 379 U.S. 594 (1965)	8
SEC v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963)	8

TABLE OF AUTHORITIES—Continued

	Page
Wallenius Bremen G.m.b.H. v. *United States*, 409 F.2d 994 (4th Cir. 1969), *cert. denied*, 398 U.S. 958 (1970)	17
In re Washington Group, Inc., 476 F. Supp. 246 (M.D.N.C. 1979)	12, 15

Statutes and Regulations

Fed. R. Bankr. P. 801	8
Fed. R. Bankr. P. 10-208(a)	2, 3
Fed. R. Bankr. P. 10-801	8
11 U.S.C. § 47(a)(9) (1976)	12
11 U.S.C. § 64(a)(1)	12
11 U.S.C. § 110 (1976)	2, 10
11 U.S.C. § 541(a)-(b) (Supp. III 1979)	10
11 U.S.C. § 567(1), (3), (5), (6) (1976)	10
11 U.S.C. § 586 (1976)	2, 10
11 U.S.C. § 587 (1976)	2, 10
11 U.S.C. § 588 (1976)	10
11 U.S.C. § 589 (1976)	2, 10
11 U.S.C. § 1102 (Supp. III 1979)	9
11 U.S.C. § 1103 (Supp. III 1979)	9
11 U.S.C. § 1104 (Supp. III 1979)	9
11 U.S.C. § 1106 (Supp. III 1979)	10
11 U.S.C. § 1107 (Supp. III 1979)	10
11 U.S.C. § 1108 (Supp. III 1979)	10
11 U.S.C. § 1109(a) (Supp. III 1979)	9
11 U.S.C. § 1125 (Supp. III 1979)	9
11 U.S.C. prec. 101 note (Supp. III 1979)	3
28 U.S.C. § 1254(1) (1976)	2
28 U.S.C. § 1334 (1976)	8

Miscellaneous

Admin. Office of the U.S. Courts, Tables of Bankruptcy Statistics (1979)	12
Annual Report of the Director of the Administrative Office of the United States Courts (1979 & 1980 eds.)	12
4A Collier on Bankruptcy (14th ed. 1978)	10

TABLE OF AUTHORITIES—Continued

	Page
Fischer, *Contribution in 10b-5 Actions*, 33 Bus. Law. 1821 (1978)	16
Proposed Chandler Act: Hearings on H.R. 6439 before the House Comm. on the Judiciary, 75th Cong., 1st Sess. (1937)	9
H.R. Rep. No. 1409, 75th Cong., 1st Sess. (1937)	10
Restatement of Security (1941)	17
Restatement (Second) of Agency (1958)	17
SEC, Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (1937-1940)	9

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Webster A. Collins, Herbert R. Morrison, Helen O. Morrison, and Glen A. Wilkinson respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The opinion of the district court is reported at 476 F. Supp. 246 (M.D.N.C. 1979). Appendix at 4a through 14a. The opinion of the United States Court of Appeals for the Fourth Circuit has not been reported. Appendix at 1a through 3a.

JURISDICTIONAL STATEMENT

The judgment of the United States Court of Appeals for the Fourth Circuit was entered on November 4, 1980. Appendix at 25a through 26a. A timely Petition for Re-

hearing and Rehearing En Banc was denied on January 19, 1981. Appendix at 27a through 28a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

APPLICABLE STATUTES AND REGULATIONS

Sections 70(a), 186, 187 and 189 of the Bankruptcy Act, 11 U.S.C. §§ 110(a), 586, 587 and 589 (1976), and Rule 10-208(a) of the Federal Rules of Bankruptcy Procedure are set forth in the Appendix at 29a through 33a.

STATEMENT OF THE CASE

Petitioners seek review of the decision of the court of appeals denying the Washington Group's reorganization trustee any power to cooperate with the company's defrauded investors by paying their costs in a joint lawsuit asserting overlapping claims[1] against the company's former management and others charged with defrauding the investors.[2] Despite the fact that the trustee's cooperation with the investors would have benefited the debt-

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[1] As used herein, the phrase "overlapping claims" refers to claims that, although not identical, share common factual and legal bases and are asserted by the trustee and the defrauded investors.

[2] The bankruptcy court initially authorized the trustee to fund two companion civil actions related to the reorganization proceedings described herein. Gilbert v. Bagley, No. C-78-335-WS (M.D. N.C., filed July 26, 1978); Fulk v. Bagley, No. C-78-333-WS (M.D. N.C., filed July 26, 1978). Subsequently, the district court and the Fourth Circuit denied that authority. Joint appellants below, plaintiffs in both civil actions, were George W. Fulk, Thomas W. Shelton, William F. Suddeth, Webster A. Collins, Herbert R. Morrison, Helen O. Morrison, W. O. Gregory (who recently, by reason of illness, has requested leave of court to withdraw from that action, but continues to be a claimant in the reorganization proceedings), Glen A. Wilkinson and R. A. Gilbert, Trustee. Because there are special statutory and equitable considerations applicable solely to the employee claims asserted in *Fulk*, in which Fulk, Shelton and Suddeth are plaintiffs, a separate petition is being filed on behalf of those three persons.

ors' estate by relieving it of the investors' parallel claims [3] against the company, the lower court reversed the bankruptcy court's order authorizing the trustee's expenditures. Although this case involves the specific question of whether such expenditures are proper, it also raises the broader question of whether a reorganization trustee should be prohibited from taking economically prudent steps which any reasonable fiduciary would wish to take.

Reorganization proceedings involving The Washington Group, Inc. ("Washington Group" or "the company") and its subsidiaries (collectively "the debtors") were commenced in 1977.[4] Thereafter, the trustee in reorganization conducted the investigation required by Rule 10-208(a) of the Federal Rules of Bankruptcy Procedure [5] pertaining to the circumstances leading to the need for reorganization. The trustee then filed a Rule 10-208

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[3] As used herein, the phrase "parallel claims" describes claims which are actionable against both the debtor in a reorganization proceeding and other defendants in a civil action; but for the pendency of the reorganization proceeding, the debtor could also be a defendant in such civil action. Successful prosecution of and recovery upon such claims in the civil action would discharge the debtor from any liability thereupon.

[4] Chapter X, together with the rest of the Bankruptcy Act, has been superseded by the Bankruptcy Reform Act of 1978, which revised and recodified the existing federal laws relating to liquidations and reorganizations of insolvent debtors. Pub. L. No. 95-598, 11 U.S.C. prec. 101 note (Supp. III 1979). Cases commenced prior to September 30, 1979, however, are to be "conducted and determined under [the Bankruptcy] Act as if [the Bankruptcy Reform] Act had not been enacted, and the substantive rights of parties in connection with any such bankruptcy case, matter, or proceeding shall continue to be governed by the law applicable . . . as if the [Bankruptcy Reform] Act had not been enacted." *Id.* There are, in any event, no significant differences between the Bankruptcy Act and the new Bankruptcy Code with respect to the issues in this case. Subsequent references to the Bankruptcy Act will be to the 1976 edition of the U.S. Code. References to the Bankruptcy Reform Act will be to Supp. III of the 1979 edition of the U.S. Code.

[5] Subsequent references to the Federal Rules of Bankruptcy Procedure will be as follows: "Rule ——."

report which documented the evidentiary support for numerous claims available to the debtors and to Washington Group investors arising from apparent mismanagement and fraud.

The trustee concluded that the debtors had substantial mismanagement claims against certain former officers, directors and other fiduciaries, including respondents Gilley and Johnston. Fourth Circuit Appendix at 66-69 ("Fourth Cir. App."). For example, in mid-1973 the Washington Group management entered into an employment contract with Johnston extending over an eighteen-year period and providing for total direct payments of $5,750,000, an amount which grossly exceeded the value of his actual or potential services to the company. *Id.* at 83-88. Another substantial claim identified by the trustee pertained to the company's gratuitous payment of the legal fees incurred by its co-defendants in the case of *Shaffner* v. *Washington Group, Inc.*, No. C-37-WS-73 (M.D.N.C., filed Jan. 23, 1973). In *Shaffner*, shareholders of the former Washington Mills Company, which was merged with a company controlled by respondent Gilley and Smith Bagley to form Washington Group, asserted that the merger had been effected by means of fraud and other unlawful acts. Fourth Cir. App. at 75-79. Although the company probably had no obligation to indemnify its co-defendants in *Shaffner*, it nevertheless assumed in settlement the entire burden of paying $709,000 in legal fees of all but one defendant. *Id.* at 102-04. The trustee's report leaves little doubt that the debtors' need for reorganization under Chapter X resulted from mismanagement and gross waste. *Id.* at 76-110.

The trustee's report also revealed that the facts supporting such claims of the trustee against various parties also supported substantial securities fraud claims by Washington Group investors against former management and others, and that such claims might also be made

against Washington Group in the reorganization proceedings on the theory of vicarious liability. Washington Group financial statements had chronically overstated the company's earnings by a total of $6,624,000 during the four-year period from 1973 to 1976, *id.* at 277-79; one substantial item that was improperly reported was the Johnston contract discussed above. *Id.* at 273-74, 277. Similarly, the trustee's findings as to the *Shaffner* case indicate that the *Shaffner* plaintiffs were fraudulently induced to enter into a settlement whereby minority shareholders were to be allowed to resell their shares to the company for $19 per share, and that the minority shareholders were thereafter fraudulently induced not to tender their shares. *Id.* at 82-83. Not only did Washington Group and its management issue materially false financial statements during the relevant period,[6] but management also manipulated the market price of Washington Group stock by, for example, stripping the debtors' employee benefit plans of such "blue chip" securities as IBM, Xerox and CBS in order to purchase common stock in the Washington Group, *id.* at 105-10,[7] pressuring employees to buy stock (while deterring any sales) and otherwise artificially increasing stock demand and reducing supply. In this fashion, management created a false picture of prosperity which could not help but mislead the investing public in general and the members of the *Shaffner* plaintiff class in particular. *Id.* at 82-83.

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[6] Reported earnings for 1973 were $3,011,552, whereas the company actually suffered a *loss* of $1,450,176 during that year. Fourth Cir. App. at 24.

[7] The blue chip stocks were sold at a loss of nearly a half million dollars, whereas their subsequent appreciation and dividend payments would have totalled over $400,000 as of June, 1978. *Id.* at 107-08. In contrast, Washington Group stock, which was purchased for the plans at peak prices, is now all but worthless. *Id.* at 106-10.

As a result of these and other findings, and recognizing the potential for multi-million dollar claims against the estate, as well as the overlap in the trustee's and the investors' claims against the ultimate wrongdoers, the trustee applied for and received from the bankruptcy judge an order, dated July 25, 1978 and hereinafter cited as the July order, specifically authorizing the trustee to assert his claims against officers, directors and others identified in his report as wrongdoers and to join with and assist defrauded investors in prosecuting such an action.

In reliance on the July order and the trustee's report, the trustee and certain investors immediately filed a joint action styled *Gilbert* v. *Bagley*, No. C-78-335-WS (M.D.N.C., filed July 26, 1978) naming as defendants all of the respondents herein and others incriminated by the trustee's report. The trustee's *Gilbert* claims are asserted on behalf of the Chapter X estate, whereas the investors' *Gilbert* claims are asserted on behalf of themselves and a class of all similarly situated persons. Nevertheless, many of the investors' claims are based on the same facts as those of the trustee. Both the trustee and the investor plaintiffs allege that the defendants breached their fiduciary duties under North Carolina law. The investor plaintiffs assert in addition that failure to disclose the financial consequences of those breaches violated federal securities laws. In order to prove their overlapping claims in the *Gilbert* action, both the trustee and the investors will be required to set forth the significant features of the company's financial history from 1972 until the commencement of the reorganization proceedings in 1977.

Subsequent to joining the investor plaintiffs in bringing these and other claims in *Gilbert*, the trustee requested the bankruptcy judge to clarify the July order and to confirm that the trustee had authority to expend

the debtors' funds for costs, other than attorneys' fees, in *Gilbert*. In that request, the trustee observed that he and the plaintiff investors had relied on the July order in commencing *Gilbert*. Fourth Cir. App. at 297. He also indicated that the manipulations and mismanagement alleged in *Gilbert* and the companion action (*Fulk* v. *Bagley*) might give rise to claims against the estate in the Chapter X proceedings. *Id.* at 299. Citing the substantial factual and legal interrelationships among the trustee's claims in *Gilbert*, the investor plaintiffs' claims in *Gilbert*, and the employee plaintiffs' claims in *Fulk*, the trustee stated that

> it would be very difficult, if not impossible, to segregate that discovery and pretrial preparation that would be of benefit, for example, solely to your Applicant [the trustee] as opposed to the class action plaintiffs . . . . Discovery into these matters and the offer of proof at the trials will clearly involve a considerable overlap of facts and issues.

Fourth Cir. App. at 300. He concluded that "it would be in the best interest of the continued administration of these reorganization proceedings to assist in defraying the reasonable and necessary costs" of prosecuting *Gilbert*. *Id.* On January 16, 1979, the bankruptcy judge, finding the facts to be as stated by the trustee, issued an order ("the January order") granting the trustee's request. Thus, the trustee and the bankruptcy judge both concluded that assistance to the investor plaintiffs would serve the economic interests of the estate.

Respondents, who are also defendants in *Gilbert*, but participate in the Chapter X proceedings in their capacities as creditors and shareholders, challenged the January order on appeal.[8] On September 5, 1979, the district

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[8] In the court below, petitioners unsuccessfully opposed respondents' appeal from the January order on timeliness grounds, but they do not seek certiorari as to that issue.

court [9] vacated the January order and directed the bankruptcy judge to deny the trustee authority to expend funds of the debtors to defray the investors' costs of prosecuting their related claims in the *Gilbert* action. Thereafter, the court of appeals adopted *per curiam* the district court opinion and denied a timely Petition for Rehearing and Rehearing En Banc.[10]

REASONS FOR GRANTING THE WRIT

I. THE DECISION OF THE COURT OF APPEALS RAISES AN IMPORTANT AND RECURRING QUESTION CONCERNING THE AUTHORITY OF THE TRUSTEE IN REORGANIZATION WHICH URGENTLY NEEDS RESOLUTION BY THIS COURT

The court below denied Washington Group's Chapter X trustee the authority to cooperate with the company's defrauded investors in the prosecution of their overlapping claims against former management and others charged with fraud. Such a holding contravenes this Court's mandate that legislation enacted for the purpose of protecting investors be construed flexibly so as to accomplish its remedial purposes. *See, e.g., SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).

Congress' primary objective in enacting Chapter X was to insure adequate protection for public investors. *SEC*

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[9] Jurisdiction of the district court was premised on 28 U.S.C. § 1334 and Rules 801 and 10-801.

[10] In the meantime, petitioners filed a proof of claims and other documents in the Chapter X proceedings seeking to preserve the rights of all defrauded investors to recover their losses from the debtors under the theory of vicarious liability. Although the bankruptcy judge has to date denied the petitioners any right to participate in the Chapter X proceedings, his order excluding their claims has been appealed to the district court not only by the petitioners but also by the SEC.

v. *American Trailer Rentals Co.*, 379 U.S. 594, 614 (1965).[11] A comprehensive study[12] relied upon in the formulation of Chapter X found investor-creditors of the debtor in reorganization unable, due to inadequate finances and inexperience, to protect their interests without assistance. SEC study, pt. II, at 1. Accordingly, the Commission recommended that in reorganization the "primary emphasis be given to the protection of the interests of investors." *Id.* pt. I, at 897. The importance of investor protection was reemphasized by the Commission in hearings on the bill which eventually became the Chandler Act:

> There is admittedly a widespread and national investor interest in these reorganization proceedings. . . . The holdings are small, and individual action by the security holders to protect themselves is, in many cases, out of the question. They either lack the funds, or the skill, the acumen or the initiative to take matters into their own hands. . . . The new system which is needed must afford not only a shield but a sword for bona-fide investors and their representatives . . . .

Proposed Chandler Act: Hearings on H.R. 6439 before the House Comm. on the Judiciary, 75th Cong., 1st Sess. 163 (1937).

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[11] The protective features of Chapter X have been carried forward into the new Bankruptcy Code. *See* 11 U.S.C. §§ 1102-1103 (Supp. III 1979) (enabling committees representing investors to play a significant role in the reorganization proceedings); *id.* § 1104 (requiring appointment of examiner and/or trustee if such appointment is in the interest of any of the debtor's investors); *id.* § 1109(a) (allowing SEC to raise, appear and be heard on any issue arising in a reorganization case); *id.* § 1125 (requiring full written disclosure of all material information prior to soliciting acceptance of reorganization plan).

[12] SEC, Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (1937-1940) ("SEC study").

The trustee is the "focal point" in the formulation and negotiation of a reorganization plan for the protection of public investors. H.R. Rep. No. 1409, 75th Cong., 1st Sess. 43-44 (1937).[13] Indeed, this Court in *Caplin* v. *Marine Midland Grace Trust Co.* recognized the trustee in reorganization as "the center of the statutory scheme." 406 U.S. 416, 423 (1972). It is the trustee who is best able to identify claims which inure directly or indirectly to the benefit of the estate, since he possesses all records of the debtor and conducts a thorough investigation of the debtor's affairs. 11 U.S.C. § 567 (1)-(3) (1976); *see* 11 U.S.C. § 1106(a)(3)-(4) (Supp. III 1979). He also occupies an advantageous position in identifying and evaluating claims *against* the estate. While the trustee is generally obligated to recognize such claims and to prepare a plan for payment thereof out of the estate's assets, 11 U.S.C. § 567(5)-(6) (1976); *see* 11 U.S.C. § 1106 (a)(2)-(5) (Supp. III 1979), parallel claims can be satisfied in a way that involves substantially less expense to the estate. When public investors have parallel claims, the trustee can most efficiently protect those investors, as well as maximize the eventual recovery for all creditors, by assisting the investors in prosecuting their parallel claims against former management and other wrong-

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[13] The Chapter X trustee's manifold powers are set forth in 11 U.S.C. §§ 110, 586-589 (1976). These powers include the power to "operate the business and manage the property of the debtor," *id.* § 589, as well as any "powers which [the debtor] might have exercised for his own benefit, but not those which he might have exercised solely for some other person." *Id.* § 110(a); *see* 4A Collier on Bankruptcy ¶ 70.13[2], at 124 (14th ed. 1978). Under the new Bankruptcy Code, the reorganization trustee has substantially identical powers. *See* 11 U.S.C. §§ 541(a)-(b), 1106, 1108 (Supp. III 1979). In the absence of fraud, dishonesty, incompetence or gross mismanagement by current management, the debtor may remain in possession, and, if so, has the same powers as the trustee would have. *Id.* § 1107.

doers. Such litigation assistance thus not only serves the statutory goal of protecting public investors but also directly benefits the estate.

The primary benefit to the estate from such litigation assistance is, of course, enhancement of the availability of debtor assets for distribution to other creditors by eliminating parallel claims against the estate which would otherwise be prosecuted in the reorganization proceedings.[14] Successful prosecution of parallel claims also relieves the estate of the burden of prosecuting third-party claims for indemnification against the actual wrongdoers. Further, when, as in *Gilbert*, the trustee has overlapping claims which he asserts in a joint lawsuit, assistance rendered his co-plaintiffs will facilitate the prosecution of his claims by avoiding substantial duplication of discovery and proof. Cooperation between the trustee and the investor plaintiffs will result in substantial savings to the estate since, in exchange for bearing their comparatively minimal litigation costs, the trustee will benefit from the work of his co-plaintiffs' counsel in pursuing their clients' related claims. It is clear, then, that successful joint prosecution of parallel and overlapping claims facilitates both the negotiation and the ultimate success of the reorganization plan. The court below, in holding that the prosecution of the *Gilbert* action would not "direct[ly] benefit" the estate, did not disagree with the trustee's and the bankruptcy judge's assessment of the economic benefits to the estate, but rather deemed such benefits insufficient

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[14] If the parallel claims were prosecuted in the reorganization, the trustee would incur both litigation costs and attorneys' fees, not to mention the possibility of ultimate liability on the claims. These expenditures would certainly exceed substantially the defrauded investors' *Gilbert* litigation costs, exclusive of attorneys' fees. Indeed, if the plaintiffs recover their litigation costs from the defendants in *Gilbert*, these sums will be restored to the estate.

to justify the expenditures merely because they were "indirect." *In re Washington Group, Inc.*, 476 F. Supp. 246, 252 (M.D.N.C. 1979).[15]

In view of the burgeoning number of reorganizations filed in recent years,[16] it is crucial that the Court define for both the reorganization trustee and potential investor plaintiffs the scope of the trustee's authority to cooperate with third parties in the prosecution of parallel and overlapping claims when successful prosecution thereof will eliminate claims against the estate. Such cooperation, which is of particular benefit to all except the wrongdoers, has been approved by various courts in a number of different forms, depending upon the circumstances of each case.[17] By obtaining authorization to cooperate with investors in the *Gilbert* action, the trustee sought to eliminate several million dollars in claims against the estate by defraying the comparatively minor out-of-pocket costs of litigating the related claims of his co-plaintiffs

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[15] If the lower court intended to rule that a trustee may not expend estate resources to minimize outflow from the estate, but only to maximize income, it was clearly wrong as a matter of law. *See, e.g.*, 11 U.S.C. § 47(a)(9) (1976) (trustee must "examine all proofs of claim and object to the allowance of such claims as may be improper"); *id.* § 64(a)(1) (trustee may incur such expenses as are necessary to preserve the estate).

[16] A total of 3,975 reorganizations were filed in 1975. By contrast, during the 12-month period from October 1, 1979 to September 30, 1980, total filings numbered 5,745. Admin. Office of the U.S. Courts, Tables of Bankruptcy Statistics (1979); Annual Report of the Director of the Administrative Office of the U.S. Courts (1979 & 1980 eds.).

[17] *E.g.*, In re Equity Funding Corp. of Am., 519 F.2d 1274, 1276 (9th Cir. 1975) (litigation fund established by trustee pursuant to compromise); In re Equity Funding Corp. of Am., 416 F. Supp. 132, 154 (C.D. Cal. 1975) (litigation fund in reorganization plan); In re Four Seasons Nursing Centers of Am., Inc., 357 F. Supp. 594, 604 (W.D. Okla. 1973) (right to apply for loan to be used as litigation "war chest").

against management and other wrongdoers. The case provides but one illustration of the practical importance of trustee assistance in civil actions. Yet if the Fourth Circuit decision is allowed to stand, it will tie the hands of reorganization trustees by denying them the authority to cooperate, financially or otherwise, in the prosecution of related claims.

Similarly, if the lower court's decision is allowed to stand, it will pose a dilemma for all persons having claims which might be filed in a reorganization proceeding or against other parties, or claims which might be joined with a trustee's claim against others.[18] As a result of that decision, any such claimant who relies on the trustee's assistance in prosecuting a civil action risks the loss, not only of his civil action claims, but also of his claims in the reorganization proceedings.[19] On the other hand,

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[18] The pressing need for resolution of the issue of the trustee's authority to assist in third-party civil actions is evidenced by the numerous cases in which reorganization claimants have had parallel claims. *See, e.g.*, Dietrich Corp. v. King Resources Co., 583 F.2d 1143 (10th Cir. 1978); American Employers' Ins. Co. v. King Resources Co., 556 F.2d 471 (10th Cir. 1977); In re Farrington Mfg. Co., 540 F.2d 653 (4th Cir. 1976); In re Four Seasons Nursing Centers of Am., Inc., 472 F.2d 747 (10th Cir. 1973); In re Credit Indus. Corp., 366 F.2d 402 (2d Cir. 1966); In re Associated Gas & Elec. Co., 149 F.2d 996 (2d Cir.), *cert. denied*, 326 U.S. 736 (1945); In re Equity Funding Corp. of Am., 416 F. Supp. 132 (C.D. Cal. 1975); Dorfman v. First Boston Corp., Fed. Sec. L. Rep. (CCH) ¶ 94,155 (E.D. Pa. 1973); Carpenter v. Hall, 311 F. Supp. 1099 (S.D. Tex. 1970).

[19] Petitioners herein, having relied on the trustee to defray the costs of the *Gilbert* action, are now in that unenviable position. The district court has indicated that the final decision as to the propriety of the trustee's commitment to fund the costs of the civil action may be dispositive as to class certification, because the plaintiffs' possible inability to defray these costs will render them,

if he should decline to cooperate with or to accept assistance from the trustee, he would be turning his back on a natural ally.

Most importantly, until this Court clarifies the scope of the trustee's authority, federal courts will be unable to streamline the complex litigation that inevitably arises when companies are forced into reorganization by the misdeeds of their management. Under the lower court's decision, overlapping and parallel claims would have to be prosecuted in different proceedings, first in the reorganization proceeding against the debtor and then in a separate action against the former management and others charged with such misdeeds. Moreover, the trustee must assert third-party claims for indemnity or contribution against the latter, which claims may well have to be litigated in yet a third action. In contrast, the litigation plan adopted by the trustee and defrauded investors herein contemplated complete resolution of all issues in a single civil action.

The specific question of a trustee's authority to fund joint civil actions has not yet been decided by this Court. Nevertheless, the lower court's opinion relied heavily and, it is respectfully submitted, incorrectly upon the opinion of this Court in *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), despite the fact that the "sole

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in the district court's view, inadequate as class representatives. *See* Gilbert v. Bagley, 492 F. Supp. 714, 720 n.1 (M.D.N.C. 1980). Thus, recovery in the civil action may be foreclosed by the Fourth Circuit's decision. Ironically, petitioners' reliance upon the trustee's assistance in the civil action may also result in the forfeiture of their claims in the reorganization proceedings. The bankruptcy judge has ruled that the investor-creditors are not entitled to pursue their claims in the Chapter X proceedings because their acceptance of the trustee's assistance estops them from proceeding against him notwithstanding that the district court has withdrawn such assistance. As noted above, the bankruptcy judge's estoppel ruling is currently before the district court on appeal.

issue" presented in *Caplin* was whether the trustee had standing to sue a debenture trustee on behalf of persons holding debentures of the debtor. 406 U.S. at 416.[20] In a 5-4 decision, this Court held that the trustee lacked such standing. However, no question of trustee standing is presented here. As the lower court itself observed, *Washington Group* does not involve trustee standing, but rather " 'the appropriateness of litigation-related expenditures which may benefit the estate.' " *In re Washington Group, Inc.*, 476 F. Supp. 246, 251 (M.D.N.C. 1979). It nevertheless reasoned that the trustee should not be allowed "to do indirectly what *Caplin* forbids his doing directly." *Id.* at 252.[21]

This case provides the Court with an opportunity to determine whether *Caplin* should be read so broadly that it constitutes a strait jacket disabling the trustee from cooperating with investors having common litigation interests as well as potential claims against the estate. A decision by this Court clarifying the scope of *Caplin* would provide much needed guidance for future reorgani-

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[20] *Caplin* denied standing for three reasons. First, the Court found no statutory basis for granting the trustee standing. 406 U.S. at 428-29. (No standing question is presented in the case at bar.) Second, the Court feared that the trustee's suit would be inconsistent with independent actions which might be brought by individual debenture holders. *Id.* at 431-34. (In *Gilbert*, the trustee's claims are closely related to, and not inconsistent with, the investors' overlapping claims.) Third, due to the doctrine of subrogation, recovery by the trustee in *Caplin* would not have benefited the estate, since to the extent that the debenture holders recovered against the debenture trustee, the debenture trustee would in turn be subrogated to their claims against the estate. *Id.* at 429-31. (There is no subrogation issue in the instant case since satisfaction of claims against former management and other actual wrongdoers would extinguish claims against the company.)

[21] In so finding, the court below ignored a prior Fourth Circuit decision mandating the award of fees and costs to a trustee's counsel for his assistance to defrauded investors in a related civil action. *See* In re Farrington Mfg. Co., 540 F.2d 653 (4th Cir. 1976).

zation trustees and claimants. *Caplin* itself provides some guidance as to the extent of a trustee's ability to assist independent civil class actions, but that guidance appears to conflict with the lower court's conclusion that the trustee must be prohibited from undertaking any such assistance. For instance, the *Caplin* Court suggested the initiation of class actions as a means of avoiding the trustee standing problem. Id. at 433.[22] Moreover, Mr. Justice Marshall recognized that, "[i]n enacting Chapter X, Congress had protection of public investors primarily in mind." 406 U.S. at 422. Yet the lower court's decision in this case would deny the trustee authority to pursue what is generally the most expedient and least costly method of protecting those investors: cooperation in the prosecution of related civil action claims. Furthermore, the *Caplin* majority emphasized the importance of reducing and simplifying litigation. 406 U.S. at 432. This goal would be frustrated if defrauded investors having parallel claims were forced to prosecute their claims in a reorganization proceeding and the trustee were thereafter compelled to pursue his resulting claims for indemnification or contribution in an independent action.[23] In con-

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[22] A major factor underlying the Court's refusal to confer standing was its concern that the trustee was substituting his judgment for that of the debtor's debenture holders in bringing suit on their behalf, and that any such suit might conflict with independent actions brought by those same debenture holders. 406 U.S. at 431-32. No such danger exists where, as in the instant case, the trustee pursues only the claims of the debtors and assists his co-plaintiffs in prosecuting their claims, thereby eliminating parallel claims against the estate.

[23] Recovery by the investor plaintiffs of their claims against the estate in the reorganization proceedings would obligate the trustee to pursue the same defendants for indemnification or contribution. *See* Marrero v. Abraham, 473 F. Supp. 1271, 1275-78 (E.D. La. 1979); McLean v. Alexander, 449 F. Supp. 1251, 1266-67 & n.49 (D. Del. 1978), *rev'd on other grounds*, 599 F.2d 1190 (3d Cir. 1979). *See generally* Fischer, *Contribution in 10b-5 Actions*, 33 Bus. Law. 1821, 1823-27 & n.12 (1978). The uncertain state of the

trast, by embarking upon a sound litigation plan similar to the one adopted in this case, the trustee can reduce and simplify the litigation by consolidating all issues in a single civil action, pitting the defrauded investors directly against the former management and other actual tortfeasors without interposing the corporate entity first as a defendant under the doctrine of vicarious liability and then as a plaintiff under theories of contribution and/or indemnity.[24] Such a litigation plan would avoid circuity of action and at the same time speed resolution of the unencumbered reorganization proceedings, all clearly within the spirit of the *Caplin* decision.

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law as to implied rights of contribution, *see, e.g.*, Northwest Airlines, Inc. v. Transcript Workers Union, 49 U.S.L.W. 3423 (U.S., argued Dec. 2, 1980) (No. 79-1056), argues even more forcefully in favor of allowing the trustee to act as he did in this case: If contribution were not available, the estate would risk liability for the *entire* amount of the investors' claims unless their civil action against former management and other wrongdoers were to succeed.

[24] Such a plan would not have eliminated claims against the estate or otherwise benefited the estate in *Caplin* because successful prosecution of the debenture trustee in the civil action would merely have enabled the debenture trustee to file identical claims in the Chapter X proceedings as subrogee of the debenture holders. 406 U.S. at 430-31. By contrast, if the plaintiffs are victorious in the *Gilbert* action, the defendants will not be subrogated to the investors' claims and thus cannot pursue those same claims against Washington Group in the reorganization proceedings. The doctrine of subrogation is inapplicable in *Gilbert* since any claims which the investors have against Washington Group are based solely on its vicarious liability for the acts of its agents. *Compare* Restatement of Security § 141 (1941) *with* Wallenius Bremen G.m.b.H. v. United States, 409 F.2d 994, 998 (4th Cir. 1969), *cert. denied*, 398 U.S. 958 (1970); Restatement (Second) of Agency § 439-440; *see also id.* §§ 401 & comment d, 438 & comment b (1958). Neither former management nor any of the other responsible parties would be entitled to seek indemnification or contribution from the company in the event that they were held liable to the investors in the civil action. In re Equity Funding Corp. of Am., 416 F. Supp. 132, 156 (C.D. Cal. 1975).

II. REVIEW OF THE JUDGMENT BELOW IS REQUIRED TO RESOLVE THE CONFLICT BETWEEN CIRCUITS

The Ninth Circuit has expressly authorized the trustee in reorganization to defray the cost of prosecuting parallel claims in related civil actions. *In re Equity Funding Corp. of America*, 519 F.2d 1274, 1276 (9th Cir. 1975). That same authority has now been denied by the Fourth Circuit. As a result of this conflict between the circuits, the right to rely on the assistance of a reorganization trustee is wholly dependent upon the fortuity of the location of the reorganization proceedings.

The Ninth Circuit in *Equity Funding* upheld then District Judge Pregerson's approval of the compromise of $314,000,000 in fraud claims in an Illinois liquidation proceeding against a subsidiary of the debtor in reorganization, whereby the sum of $1,250,000 in estate assets was allocated by the trustee to defray the costs of prosecuting claims in related civil litigation.[25] Quite properly, the court did not question the trustee's authority to provide financial assistance to the fraud claimants in the

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[25] Various creditors and shareholders of the debtor, in addition to filing claims in the reorganization proceeding, had filed civil actions against the debtor's insolvent Illinois subsidiary, which was outside the jurisdiction of the bankruptcy court, and against certain fiduciaries of the debtor and its subsidiaries. All such actions were thereafter consolidated. The fact that allocation of estate assets to this civil litigation was effectuated in a state liquidation proceeding does not diminish its precedential value, since both the bankruptcy court and the Ninth Circuit approved such payment. Indeed, the fund was later supplemented by the transfer, pursuant to the reorganization plan, of $250,000 into the registry of the civil action court. In re Equity Funding Corp. of Am., 416 F. Supp. 132 (C.D. Cal. 1975). The sum, approved by Judge Pregerson, was to be used "for the benefit of the plaintiff classes as may be defined by the [civil action] Court, in such manner as said Court may order." *Id.* at 154. A similar provision was approved in In re Four Seasons Nursing Centers of Am., Inc., 357 F. Supp. 594, 604 (W.D. Okla. 1973).

related civil action. Rather, it focused on whether the trustee's decision to settle rather than litigate the fraud claims was reasonable under the circumstances.

The decision of the Fourth Circuit Court of Appeals in *Washington Group* is in direct conflict with that of the Ninth Circuit in *Equity Funding*. The Ninth Circuit permits the trustee in reorganization to defray the costs of a civil action to which he is not even a party. *A fortiori*, the trustee would be permitted to assist his co-plaintiffs in a joint civil action, where such assistance would benefit the estate not only by eliminating parallel claims but also by facilitating the prosecution of the trustee's claims. The Fourth Circuit, ignoring *Equity Funding*, denies the trustee such authority.

CONCLUSION

For the reasons set forth above, a writ of certiorari should issue to review the judgment of the Court of Appeals for the Fourth Circuit. Alternatively, if the Court grants the related petition in *Fulk* v. *Johnston* (*see* note 2 *supra*) without also granting this petition, petitioners respectfully suggest that the Court defer action on this petition pending resolution of the *Fulk* case.

Respectfully submitted,

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April 1981

Appendices

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 79-1644

DAVID R. JOHNSTON; THE NORTHWESTERN BANK; JAMES R. GILLEY,

Appellees,

versus

R. A. GILBERT, Trustee,

Appellant,

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.;
CONVENIENT SYSTEMS, INC.;
WASHINGTON MILLS COMPANY;
JOHNSTON MILLS EXPORT COMPANY;
SPINNERS PROCESSING COMPANY;
WASHINGTON WEAVING COMPANY;
WASHINGTON MILLS SALES CORPORATION,

Debtors.

No. 79-1653

DAVID R. JOHNSTON; THE NORTHWESTERN BANK; JAMES R. GILLEY,

Appellees,

versus

GEORGE W. FULK, THOMAS W. SHELTON and WILLIAM F. SUDDETH,

Appellants,

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.;
CONVENIENT SYSTEMS, INC.;
WASHINGTON MILLS COMPANY;
JOHNSTON MILLS EXPORT COMPANY;
SPINNERS PROCESSING COMPANY;
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,

Debtors.

No. 79-1654

DAVID R. JOHNSTON; THE NORTHWESTERN BANK; JAMES R. GILLEY,

Appellees,

versus

WEBSTER A. COLLINS, HERBERT R. MORRISON, HELEN O. MORRISON, W. O. GREGORY, and GLEN A. WILKINSON,

Appellants,

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.;
CONVENIENT SYSTEMS, INC.;
WASHINGTON MILLS COMPANY;
JOHNSTON MILLS EXPORT COMPANY;
SPINNERS PROCESSING COMPANY;
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,

Debtors.

Appeal from the United States District Court for the Middle District of North Carolina, at Winston-Salem. Robert R. Merhige, Jr., District Judge

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Argued October 6, 1980 Decided November 4, 1980

Before HAYNSWORTH, Chief Judge, BUTZNER and SPROUSE, Circuit Judges

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O. William Faison; Calvin H. Cobb, Jr. and Howard H. Stahl (James D. Hutchinson, John D. Alkire, Peter L. Wellington, Steptoe & Johnson; C. Edwin Allman, R. Bradford Leggett, Hatfield & Allman; T. Winfield

Blackwell, Jr., Jack F. Canady, Jack E. Thornton, Jr., Blackwell, Blackwell, Canady & Eller; Henry A. Mitchell, Jr., Carl Patterson, Smith, Anderson, Blount, Dorsett, Mitchell and Jernigan on brief) for Appellants; W. Donald Carroll, Jr. (Jonathan E. Buchan, Helms, Mulliss & Johnston on brief); John H. Northey, III (Caudle, Underwood & Kinsey on brief); Roy G. Hall, Jr. (Hall and Liner on brief) for Appellees.

PER CURIAM:

The trustee in a Chapter X bankruptcy proceeding and past and present shareholders and employees of the debtor corporations appeal a district court judgment vacating two orders entered by the bankruptcy judge. These orders authorized the trustee to expend funds from the debtors' estate to defray the costs of two class action suits brought by employees, shareholders and, in one case, the trustee as a co-plaintiff against former officers, directors and fiduciaries of the debtors. The appellants primarily contend that the district court erred in holding that the trustee was not entitled to use funds in this manner. The parties also raise a number of threshold and procedural issues, including the correctness of the district court's ruling that the time to appeal the bankruptcy judge's orders should have been extended on grounds of excusable neglect.

We affirm for reasons sufficiently stated by the district judge in his opinion. *In re Washington Group, Inc.*, 476 F. Supp. 246 (M.D.N.C. 1979). We also find that those issues not governed by the opinion below do not compel a contrary result, and merit no further discussion.

Affirmed.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF
NORTH CAROLINA
Winston-Salem Division

In Chapter X
Reorganization Numbers

B-77-695	B-77-696
B-77-697	B-77-698
B-77-699	B-77-700
B-77-701	B-77-702

[Filed Sept. 5, 1979]

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.,
CONVENIENT SYSTEMS, INC.,
WASHINGTON MILLS COMPANY,
JOHNSTON MILLS COMPANY,
JOHNSTON MILLS EXPORT COMPANY,
SPINNERS PROCESSING COMPANY,
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,

Debtors.

MEMORANDUM

This matter is before the Court on appeal from an order of the Bankruptcy Court. The following two issues are presented: (1) whether in the circumstances of this case the Bankruptcy Judge erred in denying appellants an extension of time within which to file their appeal to this Court, and (2) whether the Bankruptcy Judge erred in allowing the Trustee in Bankruptcy to expend funds of the Debtors' estate to assist in defraying the costs of two potentially massive civil suits, in only one of which

the Trustee is a named plaintiff, against former officers, directors, and fiduciaries of the Debtors. The three appellants, David R. Johnston, James R. Gilley, and the Northwestern Bank, are creditors and shareholders of the bankrupt companies. Jurisdiction is proper under Bankruptcy Rule 801 and 28 U.S.C. § 1334.

On June 20, 1977, Chapter X reorganization proceedings commenced with respect to the Washington Group, Inc. and its subsidiaries. R. A. Gilbert was appointed Trustee in Bankruptcy, and he immediately began his investigation and operation of the bankrupt corporations. He filed his report to the Bankruptcy Court on June 30, 1978, and in that report he included facts pertaining to potential causes of action available to the estate.

On July 21, 1978 and July 25, 1978, respectively, the Bankruptcy Judge entered orders that (1) authorized the Trustee to assist employees of the Debtors in securing compensation for losses occasioned by mismanagement of employee benefit plans, and (2) authorized the Trustee to sue on behalf of the estate and to join with any other plaintiffs in such action. On July 25, 1978, two civil class actions suits relating to the affairs of the Debtors were filed in this court. *Gilbert* v. *Bagley*, C-78-335-WS, and *Fulk* v. *Bagley*, C-78-333-WS. *Gilbert* involves claims by the Trustee, on behalf of the Debtors, asserting waste, mismanagement, and breach of fiduciary duties by officers, directors, and other fiduciaries of the Debtors. Additionally, *Gilbert* includes claims by certain representative shareholders of the Debtor, The Washington Group, Inc., on behalf of a proposed class of such shareholders, based on alleged securities law fraud and related misconduct, as well as unlawful conduct during the pendency and settlement of an earlier shareholders' action. In *Fulk*, certain representative employees of the Debtors, on behalf of a proposed class of such employees, have asserted federal and common law claims arising

out of abuses in the management of the debtor corporations' various employee benefit plans by directors, officers, and other fiduciaries of the Debtors. The Trustee is not a party in *Fulk*. Discovery relative to class certification issues has been completed in both actions. General discovery, however, has been stayed pending resolution of a criminal action against certain of the named defendants.

On January 15, 1979, the Trustee filed an Application with the Bankruptcy Court seeking express authority to expend the funds of the Debtors for costs, other than attorneys' fees, in the *Gilbert* and *Fulk* actions, asserting that "it would be in the best interest of the continued administration of these reorganization proceedings to assist in defraying the reasonable and necessary costs of maintaining" the *Fulk* and *Gilbert* actions. No notice was given to the Debtors' creditors or stockholders. In an order dated January 16, 1979, without the benefit of any hearing, the Bankruptcy Judge granted the Application. That order stated in pertinent part:

> Upon the annexed Application of R. A. Gilbert, Trustee of the above-named Debtors, the Court having determined that said Application was one which might be heard *ex parte* and the Court having found as facts the matters stated in said Application; and for sufficient reasons appearing and good cause shown, it is
>
> ORDERED, ADJUDGED AND DECREED that the Trustee be and he is hereby authorized to use the funds of the Debtors to assist in defraying the reasonable and necessary costs of maintaining the two class actions known and designated as *Gilbert, et al.* v. *Bagley, et al.* and *Fulk, et al.* v. *Bagley, et al.*, which class actions are presently pending in the United States District Court for the Middle

> District of North Carolina, save and except payment of professional fees of the attorneys for the class action plaintiffs.

The Clerk did not, nor was he directed to, send copies or other notice of this order to counsel for any of the creditors herein.

The ten day period within which to appeal this order expired on January 26, 1979. On February 9, 1979, David R. Johnston and the Northwestern Bank both filed Notices of Appeal from the January 16, 1979 order. On the same date, Johnston and Northwestern requested pursuant to Bankruptcy Rule 802(c) that the Bankruptcy Judge retroactively extend the ten-day period. On February 12, 1979, James R. Gilley filed his Notice of Appeal from the January 16, 1979 order, but did not request a retroactive extension of time. At a hearing on February 27, 1979, the Bankruptcy Judge denied the motions of Northwestern and Johnston for a retroactive extension of time in which to appeal. An order to that effect was entered on March 12, 1979. Northwestern filed a Notice of Appeal from the March 12, 1979 order on March 21, 1979, together with a Designation of Record on Appeal and Statement of Issues. On March 23, 1979 Johnston filed a Notice of Appeal of the March 12, 1979 order, together with his Designation of Record on Appeal and Statement of Issues.

On appeal before this Court, therefore, are the two orders of the Bankruptcy Judge entered on March 12, 1979 and January 16, 1979, respectively. Consideration of the earlier dated order is dependent upon a reversal of the later order.

Any analysis of these questions must be predicated upon an understanding of the overall context of and relationship between the bankruptcy proceedings and the pending civil actions. The three appellants in this

action, James R. Gilley, David R. Johnston, and the Northwestern Bank, are all defendants in *Gilbert*, and appellants Gilley and Northwestern are defendants in *Fulk*. Appellants Johnston and Northwestern, however, are also creditors of the bankrupt Debtors, and it is in this capacity that they are seeking to reverse the order of January 16, 1979 authorizing expenditure of the estate's funds to support the *Gilbert* and *Fulk* actions. Appellant Gilley is the majority shareholder of the Washington Group, and he is similarly interested in preventing improper use of the Debtor's limited resources. Therefore, while these appellants all may legitimately attack an order the effect of which will be dilution of the bankrupts' monies, the Court cannot help but be aware that success on the issues now pending will redound to appellants' benefit in their capacities as defendants in the civil actions.[1]

The threshold inquiry is whether the Bankruptcy Judge was mistaken in denying appellants' motion for a retroaction extension of the ten day appeal period. Bankruptcy Rule 802(c) requires that requests for extensions be made within the ten day period, "except that a request made after the expiration of such time may be granted upon a showing of excusable neglect." As the District Court for the Southern District of New York has noted:

> The question of excusable neglect is left to the discretion of the Bankruptcy Court Judge whose decision should not be set aside unless the 'reviewing

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[1] It is interesting to note that appellant Johnston apparently is a defendant in *Gilbert* because the Washington Group bought out his family's closely held textile company and he remained on as an employee. The complaint in *Gilbert* does not allege that Johnston was an officer or director of the Washington Group, but he admits to being a stockholder, leading the Court to wonder whether he ought not to be a plaintiff rather than a defendant. This question of course is not before the Court, and the Court expresses no opinion relative thereto.

> court has a definite and firm conviction that the court below committed a clear error of judgment ....'

In re Gurda, 19 Collier Bankruptcy Cases 568, 569 (S.D.N.Y. 1979) (footnote omitted). For the reasons that follow, the Court has concluded that the Bankruptcy Court's order of March 12, 1979 was clearly erroneous.

Notions of fundamental fairness impel a reviewing court to look closely at actions taken ex parte. This is especially so where a Trustee in Bankruptcy is asking for approval of what could be substantial expenditure of the Debtors' funds. Creditors and shareholders of the bankrupt estates have an absolutely legitimate interest in monitoring the manner in which the estate's resources are spent, and the Trustee, as their legal representative, owes them a duty to keep them informed of his activities. *See* Bankruptcy Rule 10-209. That the instant appellants also happen to be defendants in the *Bagley* and *Fulk* actions does not in any way limit their right, as creditors and shareholders, to be informed of, and in appropriate circumstances, to participate in, important actions taken by the Trustee. The Court therefore cannot help but look initially with suspicion upon the actions taken in this matter by both the Trustee and the Bankruptcy Court.

Appellants have not cited, nor has the Court in its research discovered, either a case or Bankruptcy Rule precisely on point. Other than the broad principles enunciated above, drawn from the general spirit of the bankruptcy process, Bankruptcy Rule 10-209(b)(6) seems to be the most nearly applicable provision. It provides that the Trustees shall give all creditors and stockholders at least twenty days notice of "the hearing on applications for . . . reimbursements of expenses." *See also* Rule 10-216. Here, of course, the Trustee was not seeking reimbursement of expenses; rather, he was asking for a blank check with which to draw an undetermined, but

clearly substantial, amount from the funds of the Debtors. The Court cannot imagine a clearer instance, not explicitly covered by the Rules, in which notice to creditors and shareholders would be appropriate.

Rule 922(a) requires the Bankruptcy Court to mail notice of orders entered to any party who opposed the entry of the order. No such notice was mailed with regard to the January 16 order. The Trustee argues, however, that notice was not required because no one opposed his application. Though this may be technically correct, the Court will not penalize appellants for their failure to oppose an application submitted without notice to them and decided without giving them an opportunity to be heard.

The Trustee also argues that the January 16 order merely confirmed the authority already granted him by the Bankruptcy Court in its orders of July 11 and 25, 1978, and that, because appellants did not appeal those orders, they should not now be allowed to appeal the January 16 order. Suffice it to say that, had the July orders actually granted the Trustee the authority to use the Debtors' funds to help support the *Gilbert* and *Fulk* actions, the Court is at a loss to understand why the Trustee felt it incumbent to make further application to the Bankruptcy Court.

Appellants and the Trustee agree that appellants did not learn of the January 16 order until January 31. They further agree that appellants Johnston and Northwestern filed their notices of appeal nine days later. The tenth day, February 10, was a Saturday, and appellant Gilley filed his notice of appeal on Monday, February 12. This delay, with the attendant circumstances already discussed, quite clearly falls within the "excusable neglect" exception to the Rule 802(a) requirement that notices of appeal be filed within ten days. As the United States Court of Appeals for the Fourth Circuit has noted

in a related context: "Failure to learn of the entry of judgment is the principal ground on which extensions of time for appeal are granted." *Babich* v. *Clower*, 528 F.2d 293, 295 (4th Cir. 1975). Accordingly, the March 12, 1979 order of the Bankruptcy Court denying appellants Johnston's and Northwestern's motions for extensions of time within which to appeal the order of January 16, 1979 will be vacated, and the Bankruptcy Court will be directed to grant the motions. Because the Bankruptcy Court should have allowed appellants to file notices of appeal regarding the order of January 16, the Court will now consider the appropriateness of that order.

As a general proposition, it is beyond dispute that the Trustee's duty is to act in the best interests of the Debtors' estate. Protection of the rights and interests of creditors and shareholders, with which the Trustee is charged, depends largely upon the success of the Trustee in managing the estate, and his actions must be calculated to bring *direct* benefit to the estate. There is of course no question regarding the Trustee's authority to sue on behalf of the estate. Expenditure of the estate's funds in this regard is entirely proper, for success by the Trustee in *Gilbert* will accrue directly to the benefit of the estate. Of concern to appellants, however, is use of the estate's resources to help prosecute actions by the shareholder plaintiffs in *Gilbert* and all the plaintiffs in *Fulk*. Should these plaintiffs prevail, not one dime of their recovery will go into the treasury of the Debtors' estate.

The Trustee asserts that expenditure of the estate's funds to help support the *Gilbert* action may be justified on three grounds:

> (a) recovery by plaintiff stockholders in *Gilbert* would eliminate claims which might otherwise be made in the reorganization proceeding . . . ; (b) the close interrelationship of the claims of the

> Trustee . . . and the shareholder plaintiffs . . . clearly indicates that a strong and vigorous prosecution of the shareholders' claims through discovery and into trial would prove to be a material benefit to the discovery and proof of evidence to support the Trustee's claims; [and] (c) proof of matters which support the basis for the claims of the plaintiff shareholders against the defendants, insofar as these claims are distinct from the Trustee's action, could . . . expedite and facilitate the objection to claims which have been filed by certain of the defendants in the reorganization proceedings.

With respect to *Fulk*, the Trustee argues that "[p]ension-related claims are entitled to special consideration in a reorganization proceeding and may even be entitled to treatment as a first priority administrative expense." He further notes that the Trustee is charged with attempting to continue operation of the Debtors' estate, and that this duty cannot be fulfilled without boosting and maintaining the morale of the employees—a task made much easier if compensation owed from employee benefit plans is paid to the employees.

Notwithstanding the apparent logic of the Trustee's arguments, his authority is strictly prescribed by the Bankruptcy Act. Congress might well have decided to grant the Trustee broad license either to sue on behalf of or provide financial assistance to third parties with claims against the estate. The Court has concluded, however, that the Bankruptcy Act contemplates a narrower range of options for the Trustee. He may only bring actions and expend funds on behalf of the estate. If he is successful, his duty is then to apportion, in accordance with the provisions of the Act, whatever recovery he reaps among the various parties with claims against the estate. Claimants of course include creditors, shareholders, and in this case employees. The high priority afforded pension-related claims does not mean the Trustee

may expend funds of the estate to support a class action suit by employees, as meritorious as it may appear. It means instead that, when the time comes to attempt to satisfy the obligations of the Debtors, employees thereof are entitled to stand near the front of the line. That shareholders and employees will no doubt have claims against the estate does not justify the Trustee's reaching into the estate's coffers to help them sue former officers, directors, and fiduciaries of the estate. The shareholders and employees' causes of action against these defendants are independent from whatever claims they may also wish to pursue against the estate.

The leading case in this area, cited and relied upon by both the Trustee and the appellants, is *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972). As the Trustee notes in his brief, *Caplin* is a decision regarding a "Trustee's standing to sue, not . . . the appropriateness of litigation-related expenditures which may benefit the estate." That the Supreme Court did not have occasion to address this latter issue does not prevent this Court from applying to the instant case the principles on which *Caplin* rests.

Caplin involved a suit brought by a Chapter X Trustee, on behalf of those persons owning debentures issued by the bankrupt company, against the indenture trustee for breach of its duty owed to the debenture holders. The Trustee in *Caplin* argued, among other things, that it was in a "better position than debt investors to discover and to prosecute claims based on the alleged failure of an indenture trustee to live up to the provision of the indenture." *Id.* at 427. The Court disagreed, noting that "Congress has established an elaborate system of controls with respect to indenture trustees and reorganization proceedings, and nowhere in the statutory scheme is there any suggestion that the trustee in reorganization is to assume the responsibility of suing third parties on behalf of debenture holders." *Id.* at 428. Then, in a

passage critical to the instant case, the Court referred to 11 U.S.C. § 567(3), which is the pivotal provision of the Bankruptcy Act prescribing the powers and duties of the Trustee, and asserted that "there is nothing in the section that enables [the Trustee] to collect money not owed to the estate." *Id.* The rationale of the Court's holding in *Caplin* is unmistakable. The Trustee may only act for the direct benefit of the estate. In asking this Court to limit *Caplin* to cases where the Trustee actually is suing on behalf of some third party claimant, as opposed to cases where the Trustee is merely footing the bill, the Trustee is requesting the Court to allow him to do indirectly what *Caplin* forbids his doing directly.[2]

For the foregoing reasons, the Court has concluded that the Bankruptcy Court's order of January 16, 1979 must be vacated, and the Trustee's application of January 15, 1979 must be denied to the extent it sought authority to use the funds of the estate to help support claims other than that brought by the Trustee.

An appropriate order shall issue.

/s/ Robert R. Merhige
United States District Judge

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[2] At least two other courts have applied this rationale. In *Rochelle* v. *Marine Midland Grace Trust Co.*, 535 F.2d 523, 527 (9th Cir. 1976), Judge Hufstedler cited *Caplin* in summarily affirming the district court's dismissal of a suit brought by the Trustee on behalf of the Debtor's creditors and debenture purchasers: "[A] reorganization trustee has no standing to maintain the action on the part of any person or entity other than his debtor corporation." Similarly, in *King* v. *Sharp*, 63 F.R.D. 60, 63 (N.D. Tex. 1974), the Court noted that: "Congress has not seen fit to endow a Chapter X Trustee with the freedom to champion causes that will produce benefits to third parties. If the bankrupt estate has no cause of action in its own right, then the Trustee has no authority to institute suits as a class representative or otherwise for the benefit of third parties."

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF
NORTH CAROLINA
Winston-Salem Division

In Chapter X
Reorganization Numbers

B-77-695	B-77-696
B-77-697	B-77-698
B-77-699	B-77-700
B-77-701	B-77-702

[Filed Sept. 5, 1979]

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.,
CONVENIENT SYSTEMS, INC.,
WASHINGTON MILLS COMPANY,
JOHNSTON MILLS COMPANY,
JOHNSTON MILLS EXPORT COMPANY,
SPINNERS PROCESSING COMPANY,
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,
Debtors.

ORDER

For the reasons stated in the memorandum of the Court this day filed, and deeming it proper so to do, it is ADJUDGED and ORDERED as follows:

1. The orders of the Bankruptcy Court dated March 12, 1979 and January 16, 1979 are hereby vacated; and

2. The Bankruptcy Court is directed (a) to enter an order granting appellants' request for a retroactive extension of time within which to file their Notices of

Appeal, and (b) to enter an order denying the Trustee's application of January 15, 1979 requesting authority to utilize funds of the Debtors to defray the costs of prosecuting *Gilbert, et al.* v. *Bagley, et al.*, No. C-78-335-WS, and *Fulk, et al.* v. *Bagley, et al.*, No. C-78-333-WS, except that the Trustee may utilize the Debtor's fund to prosecute that portion of the *Gilbert* action in which the Trustee is suing on behalf of the Debtors' estate:

Let the Clerk send copies of the memorandum and this order to all counsel of record.

/s/ Robert Merhige
ROBERT MERHIGE
United States District Judge

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF
NORTH CAROLINA

In Chapter X
Reorganization Numbers

B-77-695, B-77-696,
B-77-697, B-77-698,
B-77-699, B-77-700,
B-77-701, B-77-702

[Filed: July 25, 1979]

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.,
CONVENIENT SYSTEMS, INC.,
WASHINGTON MILLS COMPANY,
JOHNSTON MILLS COMPANY,
JOHNSTON MILLS EXPORT COMPANY,
SPINNERS PROCESSING COMPANY,
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,
Debtors.

ORDER GRANTING AUTHORITY TO PROSECUTE LEGAL ACTIONS BASED ON FRAUD, MISCONDUCT, IRREGULARITIES, OR MISMANAGEMENT OF THE DEBTOR CORPORATIONS

At Greensboro, in said district, on the 25th day of July, 1978.

Upon the annexed Application of the Trustee for the above-named Debtors, the Court having found the facts to be as stated therein, and for good cause shown; it is

ORDERED that R. A. Gilbert, Trustee, be, and he is hereby, granted permission and authority to take whatever action is deemed appropriate to assert claims or causes of action based on fraud, misconduct, irregularities, or mismanagement of the Debtor corporations against any and all corporations, entities or individuals who might be deemed liable for such acts, and, if the Trustee deems it appropriate, that he be, and he is hereby, granted authorization to join with other plaintiffs in the prosecution of such claims or causes of action.

/s/ Rufus W. Reynolds
RUFUS W. REYNOLDS
Bankruptcy Judge

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT
OF NORTH CAROLINA

In Chapter X Reorganization Numbers

B-77-695, B-77-696,
B-77-697, B-77-698,
B-77-699, B-77-700,
B-77-701, and B-77-702.

[Filed Jan. 15, 1979]

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.,
CONVENIENT SYSTEMS, INC.,
WASHINGTON MILLS COMPANY,
JOHNSTON MILLS COMPANY,
JOHNSTON MILLS EXPORT COMPANY,
SPINNERS PROCESSING COMPANY,
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,
Debtors.

ORDER AUTHORIZING EXPENDITURE OF FUNDS FOR COSTS IN PLENARY CLASS ACTIONS

At Greensboro, N. C., in said District, this 16th day of January, 1979.

Upon the annexed Application of R. A. Gilbert, Trustee of the above named Debtors, the Court having determined that said Application was one which might be heard *ex parte* and the Court having found as facts the matters stated in said Application; and for sufficient reasons appearing and good cause shown, it is

ORDERED, ADJUDGED AND DECREED that the Trustee be and he is hereby authorized to use the funds of the Debtors to assist in defraying the reasonable and necessary costs of maintaining the two class actions known and designated as *Gilbert, et al.* v. *Bagley, et al.* and *Fulk, et al.* v. *Bagley, et al.*, which class actions are presently pending in the United States District Court for the Middle District of North Carolina, save and except payment of professional fees of the attorneys for the class action plaintiffs.

/s/ Rufus W. Reynolds
RUFUS W. REYNOLDS
Bankruptcy Judge

APPENDIX F

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT
OF NORTH CAROLINA

In Chapter X Reorganization Numbers

B-77-695, B-77-696,
B-77-697, B-77-698,
B-77-699, B-77-700,
B-77-701, and B-77-702.

[Filed Mar. 12, 1979]

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.,
CONVENIENT SYSTEMS, INC.,
WASHINGTON MILLS COMPANY,
JOHNSTON MILLS COMPANY,
JOHNSTON MILLS EXPORT COMPANY,
SPINNERS PROCESSING COMPANY,
WASHINGTON WEAVING COMPANY and
WASHINGTON MILLS SALES CORPORATION,
Debtors.

ORDER DENYING MOTIONS FOR EXTENSION OF TIME IN WHICH TO FILE NOTICE OF APPEAL

At Greensboro, in said district, on the 12th day of March, 1979.

This matter coming on for hearing and being heard on the motions of The Northwestern Bank and David R. Johnston seeking an extension of time in which to file notice of appeal of an order entered by this Court on January 16, 1979, and the Court finding that said motions were not filed within ten days following the date of entry of said order; and the Court having concluded

that it does not have authority under the provisions of Rule 802(c) and Rule 10-801, Rules of Bankruptcy Procedure, to extend the time for filing notice of appeal once the initial ten-day period has expired; and the Court further concluding that if it did have such authority, in the exercise of its discretion it would deny the motions for extension of time in which to file notice of appeal; it is

ORDERED that the motions filed on behalf of The Northwestern Bank and David R. Johnston on February 9, 1979 seeking an extension of time for filing their notices of appeal be, and the same hereby are, denied, and since this Court has concluded it is without authority to act, such denial is without prejudice to The Northwestern Bank and David R. Johnston to renew and present these same motions to the United States District Judge.

/s/ Rufus W. Reynolds
RUFUS W. REYNOLDS
Bankruptcy Judge

APPENDIX G

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 79-1644

DAVID R. JOHNSTON; THE NORTHWESTERN BANK; *et al.*,
Appellees

v.

R. A. GILBERT, TRUSTEE,
Appellant

No. 79-1653

DAVID R. JOHNSTON; THE NORTHWESTERN BANK; *et al.*,
Appellees

v.

GEORGE W. FULK, *et al.*,
Appellants

No. 79-1654

DAVID R. JOHNSTON; THE NORTHWESTERN BANK; *et al.*,
Appellees

v.

WEBSTER A. COLLINS, *et al.*,
Appellants

ORDER

On September 5, 1979 the district court reversed a January 16, 1979 order of the bankruptcy court authorizing the expenditure of funds and costs in two class actions, the short styles of which are *Gilbert* v. *Bagley*, No. C-78-335-WS (M.D. N.C.), and *Fulk* v. *Bagley*, No. C-78-333-WS (MD NC) [sic]. The expenditure of funds

and costs was to be used by the trustee to aid and assist in the prosecution of said civil suits on behalf of the bankrupt estate, which had been authorized by order dated July 21, 1978.

Later, by opinion dated May 15, 1980, the bankruptcy court, in an opinion in another but related matter, indicated that its initial authority to proceed with the *Gilbert* and *Fulk* civil actions in the Middle District of North Carolina, and the expenditure of funds for that purpose, had been a mistake. Nevertheless, orders of the bankruptcy court, above mentioned, of July 21, 1978 and January 15, 1979, are yet extant, and, so far as we are advised, are unmodified except by the order of the district court of September 5, 1979, above mentioned, which is the order appealed from.

No reason has been brought to our attention why the orders of the bankruptcy court authorizing the trustee to proceed with the *Gilbert* and *Fulk* cases, and authorizing the expenditure of funds on that account, could not be later revoked by the bankruptcy court. If that were done, the instant appeal might well be moot. But the orders of the bankruptcy court of July 21, 1978 and January 16, 1979 are yet in full force and virtue but for the order of the district court appealed from.

We are thus of opinion the case is not now moot, and it is accordingly ADJUDGED and ORDERED that the motion to dismiss the appeal on account of mootness shall be, and the same hereby is, denied.

With the concurrences of Judge Haynsworth and Judge Hall.

/s/ H. Emory Widener
For the Court

APPENDIX H

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

November 04, 1980

TO:

Henry C. Ikenberry, Esq.
James D. Hutchinson, Esq.
Howard H. Stahl, Esq.
Laura Stone, Esq.
Charles G. Cole, Esq.

T. Winfield Blackwell, Esq.
Jack F. Canady, Esq.

Roy G. Hall, Esq.

W. Donald Carroll, Esq.

John H. Northey, Esq.
Lloyd Caudle, Esq.

NOTICE OF JUDGMENT

Judgment was entered in Case No. 79-1653 this date. The Court's opinion is enclosed.

Petition for Rehearing (FRAP 40)

Filing Time

A petition may be filed within 14 days after judgment. *No extensions will be granted save for the most compelling reasons.* Requests based on grounds such as miscalculation of time or a need to consult with others will be peremptorily denied.

Purpose

A petition should only be made to direct the Court's attention to one or more of the following situations:

1. A material fact or law overlooked in the decision.
2. A change in the law which occurred after the case was submitted and which was overlooked by the panel.
3. An apparent conflict of another decision of the Court which is not addressed in the opinion.

The filing of a petition in order merely to reargue the case is an abuse of the privilege.

Statement of Counsel

A petition shall contain an introductory statement that, in counsel's judgment, one or more of the situations exists which is described in the "Purpose Section" discussed above. Thereafter, the points to be raised, succintly stated, shall then be listed in the statement. Lacking such a statement, the petition will be returned to counsel without filing.

Form

The 15 page limit allowed by the Rule shall be observed. The Court requires 15 copies of the petition; however, a pro se party who is indigent may file the original only.

Bill of Costs (FRAP 39)

Filing Time

A party to whom costs are allowed, who desires taxation of costs, shall file a bill of costs within 14 days after judgment.

Mandate (FRAP 41)

Issuance Time

The mandate is issued 21 days after judgment. A timely petition for rehearing will stay the issuance. If the petition is denied, the mandate will issue 7 days later. If a stay of mandate is sought, only the original of a motion need be filed.

WILLIAM K. SLATE, II
Clerk

Enclosure

4CCA 28
Rev. 9/17/79

APPENDIX I

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Nos. 79-1644, 79-1653, 79-1654

[Filed Jan. 19, 1981]

DAVID R. JOHNSTON, THE NORTHWESTERN BANK, JAMES R. GILLEY,

Appellees,

vs.

R. A. GILBERT, TRUSTEE, GEORGE W. FULK, THOMAS W. SHELTON, WILLIAM F. SUDDETH, WEBSTER A. COLLINS, HERBERT R. MORRISON, HELEN O. MORRISON, W. O. GREGORY and GLEN A. WILKINSON,

Appellants,

IN THE MATTER OF:

THE WASHINGTON GROUP, INC.,
CONVENIENT SYSTEMS, INC.,
WASHINGTON MILLS COMPANY,
JOHNSTON MILLS EXPORT CO.,
SPINNERS PROCESSING CO.,
WASHINGTON WEAVING CO., and
WASHINGTON MILLS SALES CORP.,

Debtors.

ORDER

Upon consideration of the petition for rehearing, no request for a poll of the court being made on the suggestion for rehearing *en banc*, and with the concurrence of Judge Butzner and Judge Sprouse,

IT IS ORDERED that the petition be, and it is hereby, denied.

FOR THE COURT:

/s/ Clement F. Haynsworth
Chief Judge
Fourth Circuit

January 14, 1981

APPENDIX J

Sections 70(a), 186, 187 and 189 of the Bankruptcy Act, 11 U.S.C. §§ 110(a), 586, 587 and 589 (1976) provide:

§ 110. Title to property

(a) The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this title, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located (1) documents relating to his property; (2) interests in patents, patent rights, copyrights, and trademarks, and in applications therefor: *Provided*, That in case the trustee, within thirty days after appointment and qualification, does not notify the applicant for a patent, copyright, or trade-mark of his election to prosecute the application to allowance or rejection, the bankrupt may apply to the court for an order revesting him with the title thereto, which petition shall be granted unless for cause shown by the trustee the court grants further time to the trustee for making such election; and such applicant may, in any event, at any time petition the court to be revested with such title in case the trustee shall fail to prosecute such application with reasonable diligence; and the court, upon revesting the bankrupt with such title, shall direct the trustee to execute proper instruments of transfer to make the same effective in law and upon the records; (3) powers which he might have exercised for his own benefit, but not those which he might have exercised solely for some other person; (4) property transferred by him in fraud of his creditors; (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon

and sold under judicial process against him, or otherwise seized, impounded, or sequestered: *Provided*, That rights of action ex delicto for libel, slander, injuries to the person of the bankrupt or of a relative, whether or not resulting in death, seduction, and criminal conversation shall not vest in the trustee unless by the law of the State such rights of action are subject to attachment, execution, garnisment, sequestration, or other judicial process: *And provided further*, That when any bankrupt, who is a natural person, shall have any insurance policy which has a cash surrender value payable to himself, his estate, or personal representatives, he may, within thirty days after the cash surrender value has been ascertained and stated to the trustee by the company issuing the same, pay or secure to the trustee the sum so ascertained and stated, and continue to hold, own, and carry such policy free from the claims of the creditors participating in the distribution of his estate under the bankruptcy proceedings, otherwise the policy shall pass to the trustee as assets; (6) rights of action arising upon contracts, or usury, or the unlawful taking or detention of or injury to his property; (7) contingent remainders, executory devises and limitations, rights of entry for condition broken, rights or possibilities of reverter, and like interest in real property, which were nonassignable prior to bankruptcy and which, within six months thereafter, become assignable interests or estates or give rise to powers in the bankrupt to acquire assignable interests or estates; and (8) property held by an assignee for the benefit of creditors appointed under an assignment which constituted an act of bankruptcy, which property shall, for the purposes of this title, be deemed to be held by the assignee as the agent of the bankrupt and shall be subject to the summary jurisdiction of the court.

All property, wherever located, except insofar as it is property which is held to be exempt, which vests in the

bankrupt within six months after bankruptcy by bequest, devise or inheritance shall vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification, as of the date when it vested in the bankrupt, and shall be free and discharged from any transfer made or suffered by the bankrupt after bankruptcy.

All property, wherever located, except insofar as it is property which is held to be exempt, in which the bankrupt has at the date of bankruptcy an estate or interest by the entirety and which within six months after bankruptcy becomes transferable in whole or in part solely by the bankrupt shall, to the extent it becomes so transferable, vest in the trustee and his successor or successors, if any, upon his or their appointment and qualification, as of the date of bankruptcy.

The title of the trustee shall not be affected by the prior possession of a receiver or other officer of any court.

§ 586. Trustee; title

A trustee, upon his appointment and qualification, shall be vested with such title as a trustee appointed under section 72 of this title would have.

§ 587. Rights, powers, and duties of trustee

Where not inconsistent with the provisions of this chapter, a trustee, upon his appointment and qualification, shall be vested with the same rights, be subject to the same duties, and exercise the same powers as a trustee appointed under section 72 of this title, and, if authorized by the judge, shall have and may exercise such additional rights and powers as a receiver in equity would have if appointed by a court of the United States for the property of the debtor.

§ 589. Operation of business and management of property; reports

A trustee or debtor in possession, upon authorization by the judge, shall operate the business and manage the property of the debtor during such period, limited or indefinite, as the judge may from time to time fix, and during such operation or management shall file reports thereof with the court at such intervals as the court may designate.

* * * *

Rule 10-208 of the Federal Rules of Bankruptcy Procedure provides:

(a) Trustee. A trustee shall (1) file the lists as required by Rule 10-108; (2) unless otherwise ordered, make a report at the meeting provided for in Rule 10-212 which shall include a summary of his operations of the business and management of the property; (3) file with the court within the times fixed by the court, periodic reports and summaries of the operations of the business, and such other information as may be required by the court; (4) investigate the acts, conduct, liabilities and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, and any other matter relevant to the case or to the formulation of a plan; (5) file a report with the court concerning any facts ascertained by him pertaining to fraud, misconduct, mismanagement, and irregularities, and to any cause of action available to the estate; (6) if the court so authorizes, examine the directors and officers of the debtor and any other witnesses concerning the foregoing matters; (7) as soon as practicable, file a statement of his investigations, and cause copies or a summary thereof to be mailed to the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the court may designate; (8) notify creditors and stockholders that they

may submit to him plans or suggestions for the formulation of a plan, within a time fixed by him in such notice; (9) file a plan or report as required by Rule 10-301(c)(1); (10) within 30 days after the date of the order confirming the plan or within such other time as the court may fix, file a report with the court concerning the action taken by him and the progress made in the consummation of the plan and file such further reports as the court may direct until the plan has been consummated; and (11) after consummation of a plan, file an application for a final decree showing that the plan has been consummated, and the names and addresses, if known, of the holders of claims or interests which have not been surrendered or released in accordance with the provisions of the plan and the nature and amounts of such claims or interests, and such other facts as may be necessary to enable the court to pass upon the provisions to be included in the final decree.

* * * *

Office-Supreme Court, U
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ALEXANDER L. STEVA
CLERK

Nos. 80-1754 and 80-1755

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

GEORGE W. FULK, THOMAS W. SHELTON, WILLIAM F. SUDDETH, WEBSTER A. COLLINS, HERBERT R. MORRISON, HELEN O. MORRISON, AND GLEN A. WILKINSON,
Petitioners,

versus

DAVID R. JOHNSTON, THE NORTHWESTERN BANK, JAMES R. GILLEY and R. A. GILBERT,
Respondents.

In the Matter of: The Washington Group, Inc., Convenient Systems, Inc., Washington Mills Company, Johnston Mills Export Co., Spinners Processing Co., Washington Weaving Co., Washington Mills Sales Corp., Debtors.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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TABLE OF CONTENTS

	Page
TABLE OF CASES AND AUTHORITIES	ii
OPINIONS BELOW	2
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	3
STATEMENT OF THE CASE	4
REASONS FOR NOT GRANTING THE WRITS	15
DISCUSSION OF REASONS FOR NOT GRANTING THE WRITS	21
CONCLUSION	61

TABLE OF CASES AND AUTHORITIES

Cases	Page
Brown v. Atwell, 92 U.S. 327 (1876)	42
Caplin v. Marine Midland Grace Trust Company, 406 U.S. 416 (1972)	17,27, 28,31, 33,36
Commercial Bank v. Buckingham's Executors, 5 How. 317, 12 L.Ed. 169 (1847)	42
Department of Motor Vehicles of the State of California v. Rios, 410 U.S. 425 (1973) . . .	42
In re Equity Funding Corp. of America, 519 F.2d 1274 (9th Cir. 1979)	38
In re Farrington Manufacturing Company, 540 F.2d 653 (4th Cir. 1976)	35,36 37
In the Matter of the Washington Group, Inc., 476 F.Supp. 246 (M.D.N.C. 1979).	3,12, 33
King v. Sharp, 63 F.R.D. 60 (N.D.Tex. 1974)	32

Cases — Page

Libby v. City National Bank, 592 F.2d 504 (9th Cir. 1978) . . 25

Matter of First Colonial Corp. of America, 544 F.2d 1291 (5th Cir.) cert. denied, 431 U.S. 904 (1977) 23

Rochelle v. Marine Midland Grace Trust Co., 535 F.2d 523 (9th Cir. 1976). 31

Triangle Improvement Council v. Ritchie, 402 U.S. 497 (1970) . 42,44

U.S. ex rel. The State of Louisiana v. Jack, 244 U.S. 397 (1917) 25

Warheit v. Osten, 57 F.R.D. 69 (E.D. Mich. 1973) 33

Statutes and Regulations

11 U.S.C. §48 (1953) 22

11 U.S.C. §67(c) (1968) 23

11 U.S.C. §589 (1976) 46

11 U.S.C. § 1108 (Supp. III 1979) . 46

29 U.S.C. §1002(21) (1976). 20,46 49

29 U.S.C. §1031 (1976). 3,47

	Page
29 U.S.C. §1105 (1976).	46
29 U.S.C. §1132 (1976).	54
29 U.S.C. §1137(b) (1976)	3,47
29 U.S.C. §1144(d) (1976)	3,18 47
Sup.Ct.R. 17 (1980)	40,41
Sup.Ct.R. 34 (1980)	46
Fed.R.App.P. 4	23,24
Fed.R.App.P. 6	23
Fed.R.Bank.P. 806	55
Fed.R.Bank.P. 10-208.	57
Miscellaneous	
Collier Bankruptcy Manual, §25.02[2] (2d.Ed.	23
Moore, Federal Practice, (Vol. 9, ¶203.06) (2d.Ed. 1975).	24

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1980

Nos. 80-1754 and 80-1755

GEORGE W. FULK, THOMAS W. SHELTON, WILLIAM F. SUDDETH, WEBSTER A. COLLINS, HERBERT R. MORRISON, HELEN O. MORRISON, AND GLEN A. WILKINSON,

Petitioners,

versus

DAVID R. JOHNSTON, THE NORTHWESTERN BANK, JAMES R. GILLEY and R. A. GILBERT,

Respondents.

In the Matter of: The Washington Group, Inc., Convenient Systems, Inc., Washington Mills Company, Johnston Mills Export Co., Spinners Processing Co., Washington Weaving Co., Washington Mills Sales Corp., Debtors.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Respondents respectfully pray the Court to deny both: (1) the petition of Webster A. Collins, Herbert R. Morrison, Helen O. Morrison and Glen A. Wilkinson ("Collins Petition") seeking a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case; and (2) the separate petition of George W. Fulk, Thomas W. Shelton and William F. Suddeth ("Fulk Petition") seeking a similar writ.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit has not been reported. It is reprinted in the appendices to both the Fulk and the Collins petitions. The opinion of the United States District Court for the Middle District of North Carolina

is reported at 476 F.Supp. 246 (M.D.N.C. 1979). It is reproduced in the appendices to both the Fulk and the Collins petitions. Petitioners' appendices contain various other orders of the courts below, and these are not reproduced again here. Both petitions omit reference to or reproduction of the May 15, 1980 opinion of the bankruptcy court below and that opinion is attached as Appendix A to this brief.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

In addition to the statutory provisions referred to in the Fulk petition and the Collins petition, sections 514(d), 111, and 507(b) of the Employee Retirement Income Security Act of 1974, 29 U.S.C. §1144(d), 1031 and 1137(b) are relevant. These

provisions are set forth in Appendix B hereto.

STATEMENT OF THE CASE

On January 15, 1979, R. A. Gilbert, trustee of the Washington Group, Inc., Convenient Systems, Inc., Washington Mills Company, Johnston Mills Company, Johnston Mills Export Company, Spinners Processing Company, Washington Weaving Company, and Washington Sales Corporation (hereinafter referred to as "Debtors"), in a Chapter X reorganization proceeding, filed an application in the Bankruptcy Court requesting an order authorizing him to expend funds of the debtors to pay expenses incurred in the prosecution of two alleged class actions: Collins, et al. v. Bagley, et al., civil action

number C-78-335-WS (M.D.N.C.) and Fulk, et al. v. Bagley, et al., civil action number C-78-333-WS (M.D.N.C.).

The bankruptcy court issued an ex parte order dated January 16, 1979 (hereinafter referred to as "January 16, 1979 order") authorizing the expenditure of the debtors' funds for the purpose of paying the expenses of an uncertified group of alleged participants in terminated employee benefit plans of the Washington Group, Inc. in Fulk. No notice of the application or order was given by the bankruptcy court or by trustee R. A. Gilbert, to any creditor or to any shareholder of the debtors.

Respondent David R. Johnston is a shareholder of the debtors and at the time of entry of the order in question

respondent James R. Gilley was majority shareholder of the debtors[1]. Respondents The Northwestern Bank and Johnston are creditors of record of the debtors in the reorganization proceeding. The trustee of the debtors, while joined with the petitioners in the initial appeal to the Fourth Circuit Court of Appeals, has not joined with the petitioners in seeking a writ of certiorari, although he has filed a brief in support of the Fulk petition.

1/ When this case was argued in the Fourth Circuit, Gilley's attorney represented to that court that Gilley had sold his stock in the debtors and no longer had an interest in this litigation.

The application for entry of the bankruptcy court's ex parte funding order came at a critical time in the development of the two lawsuits it was designed to assist.

Collins, et al. v. Bagley, et al. is principally an action by an alleged class of shareholders asserted under the federal securities laws and certain state laws. The Collins suit as originally brought included separate claims by the trustee seeking to recover on behalf of the debtors from certain individuals for alleged corporate mismanagement. The trustee is presently seeking to have his action severed from that of the alleged class of shareholders and the question of misjoinder is currently pending before the district court. No issue

concerning the trustee's individual claims has been raised in the appeal or is raised here.

Fulk, et al. v. Bagley, et al. is an action brought by the chairman of the administrative committees of certain employee benefit plans of the debtors in his capacity as a fiduciary and also by a purported class of employees and former employees of the debtors claiming vested or contingent interests under certain terminated employee benefit plans. The Fulk suit asserts claims principally under the Employee Retirement Income Security Act (ERISA) and the federal securities laws.

Both these actions were filed on July 26, 1978. The purported class action plaintiffs in each suit --

represented by the same set of law firms -- are the individuals who have filed the petitions for certiorari in this Court.

On November 6, 1978, District Judge Eugene A. Gordon entered an order establishing an orderly procedure for the handling of the Collins and Fulk cases. These orders directed initial discovery in the two cases to proceed only on the question of class certification. Discovery concerning the class question has now been completed and the issue of the propriety of class certification is pending before the district court.

The class action discovery raised serious questions concerning the adequacy of the named "representative plaintiffs." Discovery in the Collins

case in November and December, 1978 revealed that those named plaintiffs had limited their financial commitment and had agreed to pay only a small fraction of the expected costs of that action.[2] Class action discovery in

---

2/ Discovery also revealed other problems with the named plaintiffs in Collins. For example, on November 24, 1978, counsel for plaintiffs in Collins filed a class action certification brief asserting that Douglas B. Collins, one of the named plaintiffs obligated to pay the costs of this action, was an adequate, competent and proper class representative "familiar with the underlying facts in this litigation" and "participating with and assisting counsel." On December 8, 1978, after defendants noticed the deposition of Douglas B. Collins, plaintiffs' counsel filed an affidavit stating that Douglas Collins was "incapable of making full business-type judgments or using normal logic to meet every-day problems," that his father and his brother "have handled all legal and business affairs for Douglas Collins" and that "he would be unable to fulfill any of the obligations of a class representative."

the Fulk case revealed that the purported class representatives had met with their lawyers for the first time on July 24, 1978, two days before the twenty-page complaint naming them as class representatives was filed. George Fulk testified that at the time he selected the named plaintiffs more than six months before entry of the bankruptcy court's January 16, 1979 funding order he informed those employees that the expenses of the proposed class action suit to which they were to lend their names would be paid for by the trustee for the debtors.

When these questions surfaced concerning the adequacy of the class plaintiffs -- in terms of their willingness and ability to bear the

expense of the suits as well as otherwise -- the trustee sought and obtained the ex parte order from the bankruptcy court authorizing the expenditure of funds from the debtors' estates to finance the costs of the two alleged class actions. Creditors and shareholders in the reorganization proceeding appealed from that order to the United States District Court. None of the petitioners here were parties to that appeal. On September 5, 1979 the district court filed an order and memorandum of decision, finding that the bankruptcy judge had erred in allowing the trustee to expend funds of the debtors' estates to assist in bearing the cost of "two potentially massive civil suits." 476 F.Supp. 246, 247, (Fulk Petition Appendix B, p. 4a)

Thereafter, on September 14, 1979, each set of purported class plaintiffs, petitioners herein, filed with the bankruptcy court documents purporting to be proofs of claims of the uncertified classes in the Collins and Fulk suits against the debtors' estates. The tendered proofs of claims incorporated by reference the entire complaints in the Collins and Fulk actions and asserted that the reorganization trustee was liable to the respective alleged class claimants in the full amounts they sought in those two suits.

On that same date the purported class plaintiffs filed objections to the approval of plans of reorganization the bankruptcy court was then considering as a way to

relieve the financial condition of the debtors. On October 2, 1979 the purported class plaintiffs entered for the first time the proceedings arising out of the challenged January 16, 1979 order by filing a notice of appeal from the district court's September 5, 1979 order.

On May 15, 1980, the bankruptcy judge who entered the January 16, 1979 order addressed, in a ruling on a related matter, his unwillingness to allow the expenditure of funds from the debtors' estates to pay expenses incurred in the prosecution of class action activities in Collins and Fulk. (That order, not included in the appendices to petitioners' petitions, is attached as Appendix A to this brief.) The bankruptcy judge stated in his opinion:

> If the circumstances and the facts concerning these suits now known to this Court had been known at the time application for authority to expend funds for costs in these plenary class actions was made, this Court would never have entered the January 16, 1979 Order allowing such expenditures.
>
> . . . the so-called class claims and actions by Collins and Shelton-Fulk which are the basis of the alleged claims before this Court are being pursued for the benefit of the attorneys rather than for the benefit of their so-called plaintiffs and clients. (Appendix A, pp. 25a, 37a, Emphasis added.)

Thus, the judge who entered the initial funding order without notice or hearing determined, upon learning more of the relevant facts, that entry of such a funding order should not have occurred.

REASONS FOR NOT GRANTING THE WRITS

Petitioners' request for a writ of certiorari should not be granted

for, among others, the following reasons:

1. The petitioners have no right to present an issue for review in this Court because:

   (a) they were not parties to the initial proceeding before the bankruptcy court in which the January 16, 1979 Order in question was entered;

   (b) they were not parties to the proceeding on appeal to the district court in which the district court reviewed on the record the bankruptcy judge's order on appeal.

2. The controlling principles applicable to the Fulk petition and to the Collins petition were recently articulated by this Court in Caplin vs. Marine Midland Grace Trust Company, 406 U.S. 416, 92 S.Ct. 1678, 32 L.Ed. 2d 195 (1972). No court of appeals has held that the Employee Retirement Income Security Act of 1974 ("ERISA") modifies the obligations of a reorganization trustee under the Bankruptcy Act and there is no split in decisional authority in the circuit courts.

3. The argument presented in the Fulk petition that ERISA modified the Bankruptcy Act was not presented, argued or decided below and is, therefore, not properly before this Court as a basis for allowing a writ for certiorari.

4. The Fulk petitioners' assertion that their petition should be granted because ERISA modifies the duties of the trustee under the Bankruptcy Act is untenable because ERISA specifically provides, in 29 U.S.C. §1144(d), that ERISA in no way modifies or alters other federal statutes such as the Bankruptcy Act.

5. The record is devoid of facts or legal authority to support the Fulk petitioners' assertion that the reorganization trustee is not only a trustee for the debtors' estates, but is also saddled with conflicting trust obligations pursuant to ERISA. All of the employee benefit plans here at issue were terminated and their assets distributed or transferred to the Pension Benefit Guaranty Corporation prior to the entry of the January 16, 1979 funding order, and the reorganization trustee

never held any assets of any employee benefit plan. Thus, even assuming arguendo that ERISA somehow modified the Bankruptcy Act, the reorganization trustee does not meet the definition of a fiduciary set forth in ERISA, 29 U.S.C. §1002(21).

6. The record before the bankruptcy court and the record before the district court, as specified under Rule 806 of the Rules of Bankruptcy Procedure, provided no factual support for entry of the January 16, 1979 funding order and the order was, therefore properly reversed by the

district court and that reversal was properly affirmed by the Fourth Circuit Court of Appeals.

DISCUSSION OF REASONS
FOR NOT GRANTING THE WRITS

1. The petitioners have no rights to seek this review because they were not parties to the initial proceeding before the bankruptcy court which issued the January 16, 1979 order and because they were not parties to the proceeding on appeal before the district court and were not aggrieved by the entry of the September 5, 1979 order reversing the bankruptcy court's January 16, 1979 order.

The reorganization trustee participated in the initial proceedings below and the subsequent proceedings through the initial decision of the Fourth Circuit Court of Appeals, affirming the district

court's order, but did not petition this Court for review. The petitioners here were strangers to this appeal until after the September 5, 1979 order of the district court reversing the bankruptcy judge's order of January 16, 1979. Petitioners had not participated in any manner in the proceedings in the bankruptcy court, nor had they made any appearance or played any role in the proceedings before the district court prior to its September 5, 1979 order.

Until 1968 appeals from bankruptcy proceedings were governed by former §25(a) of the Bankruptcy Act, 11 U.S.C. §48 which provided: "Appeals from this act to the United States Court of Appeals shall be taken within thirty (30) days after written notice

to the aggrieved party of the entry of judgment . . . ." (Emphasis added.) In 1968, §25(a) of the Bankruptcy Act was superseded by Rules 4 and 6 of the Federal Rules of Appellate Procedure. Collier Bankruptcy Manual, §25.02[2] at p.317 (2d Ed.).[3] Rule 4 likewise provides that it is a party to a civil action in a district court, including a proceeding in bankruptcy or controversy arising therein, who may appeal to the court of appeals.

3/ The present section providing for appeals to the district court from the bankruptcy court, provides that a "person aggrieved" may appeal from an order of a bankruptcy judge to a district court. Bankruptcy Act, §39(c), 11 U.S.C. §67(c) (1968). The group (i.e. "persons") who can appeal from orders of the bankruptcy judge is therefore broader than the group (i.e.) "parties") who can appeal to the court of appeals. Matter of First Colonial Corp. of America, 544 F.2d 1291 (5th Cir.) cert. denied, 431 U.S. 904 (1977).

The rule that only a party to a proceeding below may appeal is well established in the federal courts:

> Ordinarily only a person who was a party in the Court below and who is aggrieved by the judgment or order can appeal therefrom. 9 J. Moore, Federal Practice ¶203.06 at p.715 (2d Ed. 1975).

The Fourth Circuit Court of Appeals was not required to address the issue of petitioners' right to participate for the first time at the circuit court level since the trustee was a party to the proceedings in the bankruptcy court and the district court and since he also participated in the appeal to the circuit court. However, the trustee is not seeking additional review here and the petitioners - who were not parties in the proceedings before the district court -- are not, under Rule 4, parties

who can seek review here. U.S. ex rel. The State of Louisiana v. Jack, 244 U.S. 397, 37 S.Ct. 368, 61 L.Ed. 1222 (1917).

Not only must petitioners have been parties to the proceeding before the district court, they must also have been "aggrieved" by the district court's decision in order to seek review in the circuit court and, consequently, to seek review here. The federal courts have held that in order to appeal the ruling of a court in a civil action, the party seeking to appeal must have an interest which is "immediate and pecuniary and not a remote consequence of the judgment". Libby v. City National Bank, 592 F.2d 504, 511 (9th Cir. 1978).

Petitioners are identified in the petition only as either present and former employees of the debtors and plaintiffs in Fulk or stockholders of the debtor corporations and plaintiffs in Collins. Petitioners do not, as would-be participants in the proceedings designed to reorganize the debtors, assert any direct and immediate interest they may have in the issue of whether the trustee can be allowed to fund the prosecution of the Collins and the Fulk actions. The interests these petitioners have in the outcome of that issue relate not to any interests they have as participants in the reorganization proceeding but only to their interests as plaintiffs in the two civil suits in that if the trustee is allowed to fund

these two third-party suits, the alleged "class representatives" will be able to avoid making any financial commitment to the actions. The fact that resolution of this issue has some consequential effects on petitioners in a collateral proceeding does not give them the right to intervene on appeal as an "aggrieved party".

Petitioners, therefore, were not "parties" to the orders of the bankruptcy and district courts and are not, in any event, "aggrieved" as would-be participants in the reorganization proceeding.

2. The controlling principles applicable to this case were recently articulated by this Court in Caplin v. Marine Midland Grace Trust Co., 406 U.S. 416, 92 S.Ct. 1678, 32 L.Ed. 2d 195 (1972). There is no split in decisional authority in the circuit courts.

The decisions of the bankruptcy and district courts in this case are consistent with the rationale of this Court's decision in Caplin v. Marine Midland Grace Trust Co., 406 U.S. 416, 92 S.Ct. 1678, 32 L.Ed. 2d 195 (1972), and other lower federal courts have applied Caplin the same way.

In Caplin, a corporation involved in real estate activities delivered an indenture to Marine Midland Grace Trust Company to secure the corporation's issue of debentures of a total value of approximately $8.6 million. In the indenture, the corporation agreed to maintain a two-to-one ratio of assets to liabilities to protect the investments of the debenture holders. After the corporation suffered losses for

several successive years, Marine Midland petitioned for the reorganization of the corporation under Chapter X of the Bankruptcy Act. The trustee appointed by the court found after investigation that the corporation had assets of approximately $21.5 million and liabilities of about $60 million, including approximately $4.3 million in outstanding debentures. Investigation also led the trustee to conclude that Marine Midland, the indenture trustee, had either willfully or negligently failed to fulfill its obligations under the indenture, in that it had permitted the corporation fraudulently to issue certificates showing compliance with the required ratio.

After concluding his investigation, the trustee filed an independent action on behalf of debenture holders against Marine Midland seeking to recover the principal amount of the outstanding debentures as damages for Marine Midland's alleged bad faith failure to compel the corporation's compliance with the terms of the indenture. This Court held that the trustee had no standing in his capacity as a trustee in a Chapter X reorganization to pursue claims on behalf of the debenture holders against Marine Midland. This Court squarely addressed and rejected the trustee's argument that the trustee was the proper party to take corrective action in such a situation. This Court stated that the statutory

scheme setting forth the powers of the reorganization trustee nowhere grants the trustee authority to prosecute legal actions on behalf of third parties to the reorganization proceeding. The Court noted that a change giving the reorganization trustee such powers was a policy decision to be made by Congress, not by the Court. Congress has to date refused the invitation to change that policy.

In Rochelle v. Marine Midland Grace Trust Co., 535 F.2d 523, (9th Cir. 1976), the Ninth Circuit upheld the dismissal of the securities law claims asserted on behalf of Sunset's creditors and debenture holders by the reorganization trustee of Sunset, the debtor corporation. Citing Caplin, the Ninth Circuit held that the

reorganization trustee had no standing to maintain an action on behalf of any person or entity other than the debtor corporation. 535 F.2d 523, 527 (1976).

In King v. Sharp, 63 F.R.D. 60 (N.D.Tex. 1974), the court refused to certify a class action in which a trustee in a Chapter X proceeding sought to represent a class in an action under the securities laws against defendants, who had control of the company prior to the bankruptcy petition. The court there based its decision on two determinations:

1. That the bankruptcy laws do not authorize the trustee to "champion causes" for the purpose of benefiting third parties; and

2. That a conflict was inherent in such representation since no direct benefit would accrue to the bankrupt estate from the expenditures of the funds of the estate.

Similarly in Warheit v. Osten, 57 F.R.D. 629 (E.D. Mich. 1973) the district court denied a Chapter XI receiver's motion for intervention in a securities action on the ground that the receiver did not have standing to sue on behalf of stockholders or others to enforce their claims.

As the district court below noted in its decision in this case, petitioners are:

> asking this Court to limit Caplin to cases where the Trustee actually is suing on behalf of some third party claimant as opposed to cases where the trustee is merely footing the bill [and] requesting the Court to allow [the Trustee] to do indirectly what Caplin forbids his doing directly.

476 F.Supp. 246, 252 (1979). (Fulk Petition, Appendix B, p. 14a).

The district court below recognized that the trustee in the

reorganization is not favorably positioned to decide which of many legal actions available to third parties may have some possible effect on the debtor's estate. Moreover, because the trustee is a fiduciary as to the debtor's estate, he cannot undertake the additional fiduciary duties inherent in funding a class action which may conflict with his primary obligations under the Bankruptcy Act. In this case the petitioners irreparably created such a conflict several days after the district court's decision when they filed claims against the trustee for damages for the identical alleged wrongdoing they alleged in the two purported class actions whose prosecution they are seeking to have the trustee fund.

The Fourth Circuit's decision in In re Farrington Manufacturing Company, 540 F.2d 653 (4th Cir. 1976), which was discussed in the briefs of both parties in the circuit court, does not help petitioners. Farrington involved a dispute over the allowance of fees to the trustee's legal counsel after the services for which the fees were sought had been rendered. The former trustee and his attorneys appealed the amount of the allowance of attorney's fees allowed by the district court on the ground that they were too low. The former trustee had assisted indirectly (not funded) the prosecution of a suit brought on behalf of debenture holders of the debtor corporation. The Fourth Circuit, in reversing the district court's ruling

and allowing a greater amount, considered the time spent by the attorneys for the trustee in assisting the trustee and other parties to that action. It appears from the opinion that the Fourth Circuit was deeply concerned about the trustee's limited participation in the debenture holders' suit in light of the Caplin decision.

It is important to note that the issue presented in Farrington is not the issue presented on this appeal. Farrington involved reimbursement for expenses and compensation for services rendered by the trustee or his attorney in consulting with someone involved in another lawsuit. In the instant case, what the district court below found improper--and what shareholders and

creditors object to and find unsupportable--is the "blank check" aspect of this pre-authorized payment from the funds of the estate, to attorneys not representing the trustee, for the expenses in maintaining two class actions on behalf of the third parties.

Petitioners' suggest that the courts below "ignored the Fourth Circuit's own decision in Farrington." (Fulk petition, p. 9; see Collins petition, p. 15, fn. 21.) The relevance of Farrington was discussed in the briefs submitted to the district court and to the court of appeals. The Fourth Circuit affirmed the district court's decision in a per curiam opinion and denied a request for a rehearing and a rehearing en banc.

(Collins Petition, Appendix I, p.27a.) The Fourth Circuit did not ignore or misinterpret its own prior decision.

The decision of the Fourth Circuit in this case is not in conflict with the Ninth Circuit's decision in In re Equity Funding Corp. of America, 519 F.2d 1274 (9th Cir. 1979) relied upon by petitioners. In fact, the issues decided in Equity Funding are wholly different from the issues petitioners seek to raise here. Equity Funding concerned the scope of the district court's discretion in authorizing a reorganization trustee to enter into a settlement agreement. The facts from which the Equity Funding case arose are somewhat complex and perhaps unique since when Equity went into a Chapter X reorganization proceeding, one of the

wholly owned subsidiaries, as an insurance company, remained outside the jurisdiction of the federal bankruptcy action. The subsidiary was subject to a liquidation proceeding under state law. The trustee for the debtor corporation had claims asserted against it related to the wholly-owned insurance subsidiary. In addition, the trustee himself had claims against the subsidiary. Allegedly defrauded shareholders also had claims in the Illinois liquidation proceeding. In resolving those numerous claims the bankruptcy trustee participated in a settlement agreement to which all of these entities were parties; the trustee received approval from the court for that settlement. The terms of the settlement included the setting

aside of a fund by the director of the state liquidation proceeding to be used to pay legal fees in both the Illinois liquidation proceeding and in separate proceedings which had been consolidated in one multi-district litigation forum. All of the settlement proceeds channeled to the trustee and to the defrauded claimants derived from the Illinois state liquidation proceeding.

At no time in that case was the question presented whether a reorganization trustee has authority to fund litigation on behalf of third parties, and there is no holding to that effect in that case. In summary, petitioners have failed to present a case from any other circuit conflicting with the decision of the

Fourth Circuit Court of Appeals below. See Supreme Court Rule 17.1(a).

3. The argument presented in the Fulk Petition that the Employee Retirement Income Security Act (ERISA) modified the Bankruptcy Act was not presented, argued or decided below and is, therefore, not properly before this court as a reason to allow a petition for certiorari.

Rule 17.1 of the Rules of the United States Supreme Court provides that one basis for granting a petition for a writ of certiorari is that a federal court of appeals has decided an important question of federal law which has not been, but which should be, settled by the Supreme Court. As the record in this case manifests, the issue of whether ERISA has modified the Bankruptcy Act was not presented, argued or decided in the bankruptcy

court, in the district court or in the Fourth Circuit Court of Appeals. Thus, this is not a case in which a question of federal law not settled by the Supreme Court has been decided below.

This Court has also indicated that before a petition of writ of certiorari can be granted, it must be apparent that a federal question was raised and decided "in order to induce the judgment" below. Commercial Bank v. Buckingham's Executors, 5 How. 317, 341, 12 L.Ed. 169 (1847), cited in Department of Motor Vehicles of the State of California v. Rios, 410 U.S. 425, 93 S.Ct. 1019, 35 L.Ed.2d 398 (1973). See also Brown v. Atwell, 92 U.S. 327, 23 L.Ed. 511 (1876).

In Triangle Improvement Council v. Ritchie, 402 U.S. 497, 91 S.Ct.

1650, 29 L.Ed.2d 61 (1970), this Court dismissed a writ of certiorari as improvidently granted. The Court summarized the factual situation as follows: After the writ of certiorari was granted, the statute upon which the petitioners based their case had been repealed and a new statute had been enacted by Congress, altering the impact of any decision the Court might make on the merits. The Court also noted that the petitioners in their brief on the merits in the Supreme Court had "almost completely abandoned their original claim for relief" and sought to broaden substantially the nature of the remedy they were seeking.

In dismissing the writ, the Court stated:

> It is troublesome that the petitioners have virtually abandoned their initial claim for relief. Instead of the preparation of a plan, they now seek a decree that the district court should bring before it all persons displaced by the highway and inquire whether their new locations meets statutory standards. As to this issue, there is neither an opinion below nor a record upon which to judge the claim. [Emphasis added.]

The Court noted that in light of the change in posture of the case, its adjudication would not be a "provident expenditure of the energies of the Court." 402 U.S. 497, 501-502, 91 S.Ct. 1650, 1352, 29 L.Ed. 2d 61 (1970).

The absence of presentation or discussion of this issue or a ruling on this issue below warrants a denial of this petition.

4. The Fulk petitioners' assertion that their petition should be granted because of the modification

> by ERISA of the duties of the trustee under the Bankruptcy Act is untenable because ERISA specifically provides in 29 U.S.C. 1144(d) that ERISA in no way modifies or alters other Federal statutes such as the Bankruptcy Act.

The primary thrust of the Fulk petition is that the district and circuit courts failed to harmonize "the interaction of the Bankruptcy Act and the Employee Retirement Income Security Act of 1974." (Fulk Petition, p. 8) Strikingly, the Fulk petition nowhere indicates what provision of either the Bankruptcy Act or ERISA allows a reorganization trustee to fund third-party lawsuits. Having failed to identify any provision of these statutes authorizing such action, the petition also fails to identify the purported conflict or to

specify the precise section of either statute to which the petition claims the lower court gave an "unduly restrictive interpretation." This omission is not happenstance; there is no conflict.

As required by Rule 34 of the Supreme Court Rules, both petitions have designated certain statutory provisions as being involved here. In the Fulk petition, these are designated as §3(21) and §405 of the Employee Retirement Income Security Act of 1974, 29 U.S.C. §1002(21) and §1105, and §189 of the Bankruptcy Act, 11 U.S.C. §589, recodified as 11 U.S.C. §1108 (Supp. III 1979). These provisions are set forth in the appendix to the Fulk petition. A close examination of the terms of each of

these sections shows that they provide no authority for the suggestion that the trustee is empowered to expend funds of the debtors to defray the costs of third-party litigation.

There is no dispute that the Bankruptcy Act is devoid of any authorization for the trustee to expend the debtors' funds in this fashion. Nonetheless, the Fulk petition argues that the enactment of ERISA somehow increased the authority of the trustee under the Bankruptcy Act to engage in such activities. However, even if the language of ERISA can be read to imply such an intent, which it clearly cannot, ERISA expressly provides in §1144(d) that:

> Nothing in this subchapter shall be construed to alter, amend, modify, invalidate, impair or supersede any law of the United States except as provided in

> §1031 and 1137(b) or any rule or regulation issued under any such law.

The exceptions in §1031 relate to the repeal of the Welfare and Pension Plans Disclosure Act and in §1137(b) to employee benefit plans which cover employees of the United States. Neither exception is applicable here. Thus, the Fulk petitioners' argument that ERISA somehow modifies the Bankruptcy Act flies squarely in the face of the express language of ERISA itself.

> 5. The record is devoid of facts or legal authority to support the Fulk petitioners' assertion that the reorganization trustee is not only a trustee for the debtors' estates, but is also saddled with conflicting trust obligations pursuant to ERISA.

As is set forth above, there is no

legal authority for the Fulk petitioners' argument that enactment of ERISA changed the obligations of the reorganization trustee in Chapter X proceedings. Moreover, there are no facts in this record to sustain the position that the reorganization trustee is a "fiduciary" under the provisions of ERISA. ERISA defines a fiduciary as one who exercises discretionary authority with regard to an employee benefit plan or plan assets or who renders investment advice or who has discretionary responsibility for the administration of the plan. 29 U.S.C. §1002(21).

The employee benefit plans here at issue consist principally of three types: a stock purchase plan, an employee pension plan, and three

employee profit sharing plans. No contributions to the employee pension benefit plan were made after early 1976. After the debtors filed for reorganization, administration of the assets was turned over to the Pension Benefit Guaranty Corporation. The profit sharing plans were terminated in 1976 and the assets of those plans were disbursed to the beneficiaries of the plans months prior to the June 1977 filing of the reorganization proceeding and years before the January 16, 1979 funding order was entered. The employee stock purchase plan was terminated prior to the commencement of the bankruptcy reorganization and the assets of that plan were all returned to the plan beneficiaries. Thus, the

reorganization trustee has held no employee benefit plan assets, has had no occasion to give investment advice and has administered no plan activities.

Without question, even if ERISA, contrary to the terms of the act itself, had sought to modify the trustee's powers under the Bankruptcy Act, such modificiation would not, under the facts in this record, clothe the reorganization trustee with additional fiduciary duties under ERISA.

There are strong policy reasons for not burdening the reorganization trustee with additional responsibilities under ERISA. To do so would put the trustee in conflict with his primary obligations to the

debtor's estate and to the creditors of the debtor. A trustee cannot have conflicting trust obligations and properly serve either the estates or employee plans as a trustee. Expenditure of trust funds for employee benefit plan participants conflicts with the interest of creditors in maintaining the assets of the estate. An identical problem is created by the trustee's support of lawsuits brought on behalf of the shareholders. Expenditure of funds for the benefit of shareholders places the subordinate interests of the shareholders in conflict with the interests of creditors which occupy a higher position under the Bankruptcy Act's priority rules.

That conflict is particularly striking on the facts of this record. The shareholders and employee benefit plan claimants seeking to have the trustee fund their purported class actions have subsequently turned on the trustee and have brought claims against him for the same alleged wrongs. The trustee is thus being asked to spend the debtors' funds on actions on behalf of third parties at the same time he is required to spend the debtors' funds resisting the very same claims being made against him.

The Fulk petition suggests that it is important to have the trustee fund the alleged class plaintiffs in the Fulk suit since these class plaintiffs are otherwise without means to maintain a class action. However,

that suit is also brought by Fulk in his individual capacity as chairman of the plan committees for the employee benefit plans and an alleged fiduciary for the employees. Outside funding of that suit is not required to enable him to litigate an action to recover on behalf of all beneficiaries of the employee benefit plan. Indeed, under the liberal provisions of ERISA, any fiduciary of the plan, any participant thereof, or the Secretary of Labor may bring a civil action to recover benefits due participants under the plans. 29 U.S.C. §1132.

In regard to the Collins action, it is apparent that the reason for seeking funding from the trustee was to provide a way to bolster the deficiences of the purported class

plaintiffs who, in the words of the bankruptcy judge, "are no more than 'straw claimants'" and whose "claims are made on behalf of the attorneys, not a valid certifiable group of class claimants." (Appendix A, p. 37a)

The question of the trustee's authority to fund third-party actions should not be reached because this record does not contain facts which would justify such expenditures even if such authority did, in fact, exist.

6. The record before the Bankruptcy Court and the record before the District Court, as specified under Rule 806 of the Rules of Bankruptcy Procedure, provided no factual support for entry of the January 16, 1979 Funding Order and the Order was, therefore, properly reversed by the District Court and that reversal properly affirmed by the Fourth Circuit Court of Appeals.

The record before the bankruptcy court and the record before the district court as specified under Rule 806 of the Rules of Bankruptcy Procedure provided no support for the entry for the January 16, 1979 funding order.

At the time the January 16, 1979 order was entered, the bankruptcy court had before it no sworn evidence which even purported to justify the order. Nor was there any evidence before the district court supporting the bankruptcy court's order at the time the district court rendered its decision disallowing that order.

The January 16, 1979 order recites in its preamble the following:

> The Court having found as facts the matters raised in said application....

However, that bare recitation is not supported by any factual record because: (1) the trustee's application was unsworn and consists largely of conclusory allegations; and (2) as the order itself demonstrated, no hearing was held by the bankruptcy court to take evidence on the trustee's request. The trustee's Rule 10-208 report of his ex parte investigation was never the subject of cross-examination by any parties in the Chapter X proceedings. Although that report was included at appellants' request in the appendix filed with the court below, it was not a part of the record on appeal to the district court, it is not sworn to, and it does not provide competent evidence to support the bankruptcy court's order.

After Fulk et al. and Collins et al. filed their claims in the reorganization proceedings, the bankruptcy court was given an opportunity to learn more about the facts surrounding the two actions then pending in the district court and the circumstances leading up to the January 16, 1979 funding order. On May 15, 1980 the same bankruptcy judge who had entered the January 16, 1979 funding order entered another order, addressing the bankruptcy court's unwillingness to allow the expenditure of funds from the debtors' estates to pay expenses incurred in the prosecution of class action activities in Collins and Fulk. The bankruptcy judge stated in that opinion that if the circumstances and facts concerning

these suits now known to the court had been known at the time application for authority to expend funds for costs was made, he would have never entered the January 16, 1979 order allowing such expenditures.

The bankruptcy judge's May 15, 1980 opinion--made after he had learned more about the circumstances surrounding the litigation and the attempts to obtain funding from the trustee, and not made merely as a result of an ex parte application--underscores the motivation behind petitioners' efforts to have the debtors fund the costs of their two suits.

In essence, all of the asserted "facts" petitioners discussed at length as the basis for the bankruptcy

court's order are not judicially-found facts at all, but are mere unsupported contentions of the purported class plaintiffs in the Collins and Fulk lawsuits.

CONCLUSION

For the reasons set forth above, this Court should deny the petitions for writ of certiorari to review the judgment of the Court of Appeals in the Fourth Circuit.

Respectfully submitted,

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APPENDICES

APPENDIX A

UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF
NORTH CAROLINA

IN THE MATTER OF:	)	
THE WASHINGTON GROUP, INC.; CONVENIENT SYSTEMS, INC.; WASHINGTON MILLS COMPANY; JOHNSTON MILLS COMPANY; JOHNSTON MILLS EXPORT COMPANY; SPINNERS PROCESSING COMPANY; WASHINGTON WEAVING COMPANY and WASHINGTON MILLS SALES CORPORATION,	)	IN CHAPTER X REORGANIZATION NUMBERS B-77-695, B-77-696, B-77-697, B-77-698, B-77-699, B-77-700, B-77-701, & B-77-702
Debtors.	)	

MEMORANDUM OPINION

This Memorandum Opinion is pursuant to a hearing on the following matters:

1. Application by Webster A. Collins, Herbert R. Morrison, Helen O. Morrison, W. O. Gregory and Glen A. Wilkinson to amend the Trustee's list of creditors to include

similarly situated defrauded investors, shareholders and former shareholders of the Washington Group, Inc. as set forth in the proof of multiple claims filed simultaneously with this application. (hereinafter referred to as the Collins shareholders' class claim.) This application also included a request to require notice to all potential class claimants similarly situated. This application and proof of multiple claim was filed on September 14, 1979 for $15,590,000.

2. Application by Thomas W. Shelton, William F. Suddeth and George W. Fulk to amend the Trustee's list of creditors to include all similarly situated employees of the debtors holding claims against the debtors as set forth in the proof of multiple claims filed simultaneously with this application for $2,800,000. (Here-

inafter referred to as the Shelton-Fulk employees' class claim.) This application also included a request that the class applicants receive notice of all matters pertaining to the bankruptcy proceedings. This application was filed on September 14, 1979.

3. Supplement to application of Webster A. Collins, Herbert R. Morrison, Helen O. Morrison, W. O. Gregory and Glen A. Wilkinson to amend the Trustee's list of creditors and to require notice as filed by the Collins shareholders' class claimants. This was filed on November 2, 1979.

4. Supplement to application by Thomas W. Shelton, William F. Suddeth, and George W. Fulk to amend the Trustee's list of creditors and to require notice as filed by the Shelton-Fulk employees'

class claimants. This supplement was filed on November 2, 1979.

5. Motion by A. M. Pullen to strike and dismiss application by Collins, et al. to amend Trustee's list of creditors and motion to dismiss objection to claim of A. M. Pullen, filed by Collins, et al. This motion was filed on December 17, 1979.

6. Motion by A. M. Pullen to strike and dismiss application by Shelton, et al. to amend Trustee's list of creditors and motion to strike and dismiss objection to claim of A. M. Pullen, filed by Shelton, et al. This motion was filed on December 17, 1979.

7. Motion by Calcott, Ltd. to strike and dismiss application to amend Trustee's list of creditors filed by Collins, Morrison, Morrison, Gregory, Wilkinson, Shelton, Suddeth and Fulk. This motion was filed on February 27, 1980.

8. Opposition of Northwestern Bank to application by Collins, et al. and Shelton, et al. to amend Trustee's list of creditors and to require notice. This document was filed on October 25, 1979.

9. Response of Trustee to the applications of Collins, et al. and Shelton, et al. to amend Trustee's list of creditors and objection of Trustee to proofs of multiple claims. This response was filed on November 5, 1979.

10. Objections by Collins shareholder class claimants to the below listed claims:

a. American Bank and Trust Company of Pennsylvania;

b. Smith W. Bagley;

c. The Northwestern Bank;

d. A. M. Pullen and Company;

e. David R. Johnston

These objections were filed on December 5,

1979.

11. Objections by Shelton-Fulk employee class claimants to the below listed claims:

a. American Bank and Trust Company of Pennsylvania;

b. A.M. Pullen and Company;

c. The Northwestern Bank;

d. David R. Johnston;

e. Smith W. Bagley

These objections were filed on December 5, 1979.

12. Application of American Bank and Trust Company to dismiss objections to its claims by Shelton, et al. and Collins, et al. This application was filed on December 17, 1979.

13. Application by Northwestern Bank to dismiss the objections of its claims by Shelton, et al. and Collins, et

al. This application was filed on December 17, 1979.

14. Motion by David R. Johnston to dismiss the objections to its claim by Shelton, et al. and Collins, et al. This motion was filed on December 18, 1979.

The Collins shareholder class claimants and Shelton-Fulk employees' class claimants are represented by Henry C. Ikenberry, Calvin H. Cobb, Jr., Robert E. McLaughlin, Loren Kieve, John D. Alkire and Howard H. Stahl appearing for the law firm, Steptoe and Johnson, 1250 Connecticut Avenue, N.W., Washington, D. C. 20036. (Hereinafter referred to as "Steptoe.") The Steptoe firm is associated with Blackwell, Blackwell, Canady and Eller, 2100 Wachovia Building, Winston-Salem, North Carolina 27102. (Hereinafter referred to as "Blackwell".) Smith, Anderson, Blount,

Dorsett, Mitchell and Jernigan, Post Office Box 31, Raleigh, North Carolina 27602 represents a subsequently joined party plaintiff, Glen A. Wilkinson.

The Northwestern Bank is represented by Helms, Mulliss & Johnston, 2800 NCNB Plaza, Charlotte, North Carolina 28280.

A.M. Pullen and Company is represented by Nichols, Caffrey, Hill, Evans and Murrelle, Post Office Box 989, Greensboro, North Carolina 27402.

The American Bank and Trust Company of Pennsylvania is represented by Moore and Van Allen, 3000 NCNB Plaza, Charlotte, North Carolina 28280.

The Trustee is represented by C. Edwin Allman, appearing for the law firm of Hatfield and Allman, Post Office Drawer 34, Winston-Salem, North Carolina 27101.

Counsel for the Corporate Reorganization Division of the Securities and Exchange Commission, Rodney May, represented the Securities and Exchange Commission, 1100 L. Street, N.W., Washington D. C. 20005.

David R. Johnston was represented by Wardlow, Knox, Knox, Robinson and Freeman, 1490 City National Center, Charlotte, North Carolina 28202.

All of the matters being decided in this Opinion hinge upon the determination of two central issues:

1. Should the Collins shareholder class claimants be allowed to file a proof of claim in this Chapter X proceeding?
2. Are the Collins shareholder class claimants and Shelton-Fulk

employee class claimants parties in interest for purposes of objecting to claims of creditors filed in this Chapter X proceeding?

In arriving at a solution to these problems, any reference to related actions now pending in the United States District Court for the Middle District of North Carolina will be made only for the purpose of determining the issues in this bankruptcy proceeding. This Opinion is not in any way a comment on or criticism of such actions in the District Court. The facts and conclusions found by this Court are found as a means of reaching justice in the matters pending before this Court.

These complex problems had their origin about eight years ago when a stockholders' class action suit was instituted

in the United States District Court for the Middle District of North Carolina (Civil Action #C-27-WS-73) on January 23, 1973. The full caption follows:

EMIL N. SHAFFNER,
LOUIS deS. SHAFFNER,
JANE FERRELL CLAY,
MOLLY FERRELL REILY,
CAROLINA-TEXAS CORPORATION,
WEBSTER A. COLLINS,
DOUGLAS B. COLLINS,

suing derivatively on behalf of themselves and all other stockholders of the Washington Mills Company and representatively on behalf of themselves and all other shareholders similarly situated,

Plaintiffs,

v.

WASHINGTON GROUP, INC. (formerly the WASHINGTON MILLS COMPANY),
WASHINGTON MILLS-RETAIL, INC.,
SMITH BAGLEY,
JAMES R. GILLEY,
DOUGLAS DILLARD,
JAMES W. FEATHERSTONE, III,
WALSER A. BLACKWOOD,
JOHN D. SIEWERS,
LAWRENCE G. REID,
HENRY M. LESLIE,
GEORGE E. CLAYTON, JR.,

ROBERT H. VAUGHN,
GEORGE W. FULK,
CONVENIENT SYSTEMS, INC.,
WHEAT, FIRST SECURITIES, INC.,

Defendants.

This class action alleged that there was a wrongful merger of Washington Mills-Retail, Inc., a wholly-owned subsidiary of Washington Mills Corporation and Convenient Systems, Inc. Under the terms of the merger agreement, Convenient Systems, Inc., shareholders, surrendered their stock and received one Washington Mills Corporation stock share for each three shares of Convenient Systems, Inc. stock turned in (after a 2:1 split on the Washington Mills Corporation stock). As a result of this merger agreement, Smith Bagley owned 32.5% of the outstanding Washington Mills Corporation stock, and James Gilley, 33.1%. (Smith Bagley and James Gilley later be-

came controlling stockholders and officers in the later created Washington Group, Inc. which was a holding company for Washington Mills Corporation and other subsidiaries.) Washington Mills-Retail, Inc., the newly created subsidiary of Washington Mills Corporation was the vehicle used for the merger. Convenient Systems, Inc., merging with Washington Mills-Retail, Inc. then became merged with Washington Mills Corporation, the parent corporation of Washington Mills-Retail, Inc. The loan of $2,500,000 secured by Convenient Systems, Inc. which was used to finance the purchase of Washington Mills Company stock was then assumed by the Washington Mills-Retail, Inc. As a result of the somewhat complicated merger between Washington Mills-Retail, Inc. and Convenient Systems, Inc., the aforesaid loan

of $2,500,000 became the obligation of the parent corporation Washington Mills Corporation.

This merger arrangement was the subject matter of the Shaffner complaint against Washington Mills Company and the later created Washington Group, Inc. and its officers and directors. This suit was settled out of court before the defendants filed a formal answer to the complaint. The consent judgment settling the issues was entered on August 29, 1973. The settlement provided that dissatisfied stockholders could redeem their stock at $19 a share with a future date for redemption designated or to be designated by the defendants. At the time the suit was instituted, stock was selling for about $14 a share, but by the time the redemption period arrived, the stock had

increased in market value to over $22 a share. As a result, less than $1,600 worth of stock shares were redeemed.

A total of approximately $934,000 was paid in attorneys' fees in connection with the Shaffner suit. Of these fees, approximately $225,000 was paid to Steptoe and Johnson and Blackwell and Blackwell who served as counsel representing the plaintiffs in the Shaffner case. The remaining $709,000 was paid to counsel for the defendants in the Shaffner case. The attorneys' fees for both the plaintiffs and the defendants in Shaffner were paid by Washington Group, Inc.

On June 20, 1977 the Washington Group, Inc. holding company and its totally owned subsidiaries (as listed in the caption of this Opinion) filed these Chapter X bankruptcy proceedings. All of

the proceedings have been combined for administrative purposes by Court Order. The Washington Group employs about 3,000 people. The subsidiaries are principally involved in the manufacture of apparel, manufacture of yarn, operation of sales outlets and operation of a chain of ice cream family dining establishments known as Mayberry. The total assets of Washington Group amounted to approximately $30,000,000 to $40,000,000 at the initiation of these proceedings. The Trustee in these proceedings was directed by the Court pursuant to Section 167 of the Bankruptcy Act to make a thorough investigation of all activities and matters of the corporations and officers including transfer of stock, salaries and bonuses, and possible fraud. This investigation involved depositions of numerous witnesses, documents and other

information totaling over 2,500 pages of testimony. The Trustee filed his Section 167 Investigative Report on June 30, 1978. The report contained approximately 100 pages of condensed facts obtained during the investigation. The Trustee reported that there had been stock price maneuvering and stock price support schemes which influenced the stock value beyond the real value and beyond the price it would normally have been if it had not been financially supported. Also it was reported that there had been mismanagement of the business including mismanagement of the pension plan funds of the employees.

Immediately after this 167 Investigative Report was filed, the Trustee made application to the Court for authority to institute legal actions based on fraud, misconduct, irregularities, or mismanage-

ment of the debtor corporations. This Court entered an Order to this effect on July 25, 1978. Although the application for this Order requested permission to join with other plaintiffs in the prosecution of such claims or causes of actions, the application did not set forth in detail who and how the Trustee was joining with other plaintiffs in order to recover such funds. Pursuant to the July 25, 1978 Order, an action was instituted in the United States District Court for the Middle District of North Carolina styled:

> RICHARD A. GILBERT, Reorganization Trustee of The Washington Group, Inc.,
>
> and
>
> WEBSTER A. COLLINS; DOUGLAS B. COLLINS; HERBERT R. MORRISON; HELEN O. MORRISON; W. O. GREGORY; DR. HORACE H. HICKS; Individually and as representatives of all other similarly situated shareholders of The Washington Group,

Inc. (formerly The Washington Mills Company),

Plaintiffs,

v.

SMITH W. BAGLEY; JAMES L. GILLEY; DAVID R. JOHNSTON; MICHAEL W. RIGGSBEE; THE NORTHWESTERN BANK: DEWEY W. CHAPPLE, JR.; AMERICAN BANK & TRUST CO. OF PA.; WHEAT, FIRST SECURITIES, INC.; INTER-STATE SECURITIES CORP.; WILLIAM F. THOMAS; A. M. PULLEN & CO.,

Defendants, No. C-78-335-WS.

The first 38 pages of the complaint in the Collins shareholders' class action contains allegations pertaining to the fraud involved in the Shaffner case. Almost every page refers to the Shaffner case in which the Washington Group, Inc. was a defendant and paid all the attorneys' fees and costs. The next 12 or 14 pages of the complaint allege causes of action by the Trustee on behalf of Washington Group against certain parties for fraud, mis-

conduct, irregularities and mismanagement of the debtor corporations. The class action alleges a total of approximately $2.2 million in damages and the Trustee is requesting recovery of about $10 million. With the exception of Webster A. Collins and Douglas B. Collins, none of the stockholder plaintiffs in the Shaffner case are plaintiffs in this case. Instead of reopening the Shaffner case and pursuing a cause of action against the officers individually and the debtor corporations, Steptoe and Johnson have elected to pursue a new avenue. In the Collins shareholders' class action which arose out of the Shaffner allegations, Steptoe chose to institute a new action against the former defendant officers individually and joined the former defendant corporation Washington Group, the debtor, as a joint party

plaintiff instead of being a defendant. In the controversy now before the Court, Steptoe has shifted again and now is trying to place the Washington Group in a defendant posture by attempting to file a claim against the debtor corporation. This inconsistency in pursuing the alleged cause of action and election of incompatible alternative remedies troubles this Court and will be discussed later in detail in this Opinion.

In addition to the Collins shareholders' class action, another civil action was instituted in the Federal District Court for the Middle District of North Carolina at the same time by employees alleging mismanagement and irregular manipulations of the Employees' Pension and Profit-Sharing Plans to wit:

GEORGE W. FULK, Chairman of
the Pension, Profit-Sharing,
and Stock Purchase Plan

Committees of the Washington Group, Inc.; and RUBY IRENE LESTER, IRENT TOMLINSON, THOMAS W. SHELTON, WILLIAM F. SUDDETH, suing on behalf of themselves and all other persons similarly situated,

Plaintiffs,

v.

SMITH W. BAGLEY, JAMES R. GILLEY, Individually and as Principal Officers and Members of the Board of Directors of The Washington Group, Inc.; AMERICAN BANK AND TRUST CO. OF PA., A Pennsylvania Corporation; and THE NORTHWESTERN BANK, a North Carolina Corporation,

Defendants., No. C-78-333-WS.

All plaintiffs of this action are present employees of the debtor, The Washington Group, except one. George W. Fulk is the treasurer and an executive officer of the debtor and has been in this position for several years. All of these plaintiffs are under the control and have been under the control of the Trustee

since the debtor corporations filed for reorganization. Steptoe and Blackwell are the attorneys for the plaintiffs in this action as well as the attorneys in the prior Shaffner suit.

The Trustee of the debtor corporations filed an application for authority to aid and assist in the prosecution of legal action based on claims arising out of the administration of the debtor's Profit-Sharing Plan on July 20, 1978. An Order granting authority to aid and assist in the prosecution of legal action based on claims arising out of the administration of the profit-sharing plans was entered on July 21, 1978. Later the Trustee filed a more detailed application to advance expenses for the maintenance of both the Shelton-Fulk employees' class action and the Collins shareholders' class action.

This application of the Trustee was filed on January 15, 1979 and contained the following justification for the debtor corporations financing the civil actions:

> "The successful prosecution of these actions and recovery would negate the necessity of your applicants' having to deal with the employees as claimants within the context of a plan of reorganization."

The application also stated:

> "[M]oreover, many of the employees are shareholders who would benefit from the successful prosecution of the Gilbert v. Bagley action. The assistance and morale of the employees are essential ingredients to any successvul plan of reorganization and to the financial rehabilitation of the debtors. In addition to the obvious uncertainties inherent in any reorganization proceeding, these employees have seen their hard earned employee pension, profit-sharing and stock purchase benefits and investments reduced substantially."

An Order authorizing the expenditure of

funds and costs in these plenary class actions was entered on January 16, 1979. This Order was appealed and later reversed on appeal by the District Court for the Middle District of North Carolina and since has been appealed to the Fourth Circuit. This Court (based on the Trustee's statements) allowed the Trustee to pursue these matters in Federal Court and expend debtor funds in such pursuit to avoid dealing with these large, unliquidated, class claims in the context of reorganization. If the circumstances and facts concerning these suits now known to this Court had been known at the time application for authority to expend funds for costs in these plenary class actions was made, this Court would have never entered the January 16, 1979 Order allowing such expenditures.

A list of creditors and stockholders of the corporate debtor was filed by the Trustee on August 19, 1977. This list does not contain the claims which are now alleged in the Shelton-Fulk employees' class action and the claims in the Collins shareholders' class action. The first bar date Order for filing claims was entered by this Court on February 9, 1978 requiring all creditors to file a proof of claim by February 24, 1978. A notice of this Order was not officially sent to stockholders and employees but was sent to all known potential creditors. However, all employees with the corporation and all stockholders knew or should have known that Washington Group was in a Chapter X proceeding and had been in such for some time. The proceeding was well publicized through notices, employee newsletters, news items and other news mediums.

On the 27th day of August, 1979, upon application of the Trustee, a supplementing Order was entered by this Court directing those creditors who were listed on the list of creditors and who had not filed a proof of claim as of the date of that Order, to file such on or before October 8, 1979. Another bar date Order was entered on June 20, 1977, upon the request of the Trustee and at the insistence of the attorney for the proposed purchaser of The Washington Group stock pursuant to a plan of reorganization then pending before this Court. The June 20 Order directed all potential creditors, wherever located, to file proofs of claim or be forever barred. This Order was entered only to protect the prospective purchaser in the proposed reorganization plan from potential creditors who may not have received actual notice of

the pending proceedings and bar date Orders. This Order was not intended to be a blanket extension for all parties who had prior to that time received actual notice of such, but was intended only as a newspaper publication notice to the entire world. Parties such as the Collins shareholder class claimants and Shelton-Fulk employee class claimants were not covered under this Order, because they had prior to this date received actual notice of the pending proceedings and effective bar dates. Steptoe and Johnson through their representative, Mr. Stahl, represented to this Court that they became aware of the potential claims as early as June 30, 1978 when the Section 167 Trustee's Investigative Report was filed with this Court. In addition, Steptoe and Johnson had to have been aware of the potential claim by

virtue of their involvement in the prior Shaffner litigation which the new cases are based upon. In spite of this, Steptoe and Johnson and Blackwell and Blackwell filed no proofs of claims, applications or any other matters on behalf of their clients in this Court until the 14th day of September, 1979, which was by coincidence one day before the hearing on the proposed plan of reorganization. The true facts are that Steptoe and Blackwell had no intention of filing a proof of claim in the Bankruptcy Court prior to that time and changed course merely because they were experiencing difficulty with class certification in Federal Court and a successful sale and plan of reorganization seemed imminent in Bankruptcy Court. This plan of reorganization does not recognize nor treat the Collins and Shelton-Fulk

claimants. Steptoe and Blackwell were aware of this for some time, but did not file proofs of claims until the eve of the hearing on the proposed plan. This new development made The Washington Group a defendant in Bankruptcy Court and a joint plaintiff in Federal District Court at the same time and arising out of the same matter. The filing of the proofs of claims on September 14, 1979 was the beginning of an "avalanche" of filings by Steptoe and Johnson and Blackwell and Blackwell in this bankruptcy proceeding. The filings since that date have been as follows:

1.	9-14-79	Applic. by Collins, et al. to amend Tr.'s list of creditors	1F-220 2 pgs.
2.	9-14-79	Applic. by Shelton, et al. to amend Tr.'s list of creditors	1F-221 2 pgs.
3.	9-14-79	Objection to	63F/O-213 2 pgs.

		Plan by Shelton, et al.		
4.	9-14-79	Supplement to objection to Plan by Collins, et al.	63F-249	2 pgs.
5.	9-14-79	Statement required by Rule 10-211 by Collins, et al.	63F/O-215	5 pgs.
6.	9-14-79	Supplement to objection to Plan by Shelton, et al.	63F-250	2 pgs.
7.	9-14-79	Objection to Plan by Collins, et al.	63F/O-217	2 pgs.
8.	10-17-79	Supplemental Statement of Representatives	63F-231	3 pgs.
9.	10-23-79	Pre-hearing Brief of Shelton, et al. in support of their applications to list of creditors	1F-236	16 pgs.
10.	10-23-79	Brief of claimants, Collins, et al. in support of their applications to amend list of creditors	1F-237	16 pgs.
11.	11-02-79	Supplement to application to	1F-245	3 pgs.

		amend list of creditors by Shelton, et al.		
12.	11-02-79	Supplement to application to amend list of creditors by Collins, et al.	1F-246	3 pgs.
13.	12-04-79	Reply Brief of applicants Shelton, et al. in support of their applications to amend list of creditors	1F-258	125pgs.
14.	12-04-79	Reply Brief of applicants Collins, et al. in support of their applications to amend list of creditors	1F-259	43 pgs.
15.	12-05-79	Objection to Confirmation of Plan by Shelton, et al.	63F/O-261	8 pgs.
16.	12-05-79	Objection to Confirmation of Plan by Collins, et al.	63F/O-264	8 pgs.
17.	12-05-79	Objections by Collins et al. to the below listed claims:		

	1. American Bank & Trust Co. of Pa.	53F-265	2 pgs.
	2. Smith W. Bagley	53F-266	2 pgs.
	3. The North-western Bank	53F-267	3 pgs.
	4. A.M. Pullen & Co.	53F-269	3 pgs.
	5. David R. Johnston	53F-268	3 pgs.
18. 12-05-79	Objections by Shelton, et al. to the below listed claims:		
	1. American Bank & Trust Co. of Pa.	53F-270	2 pgs.
	2. A.M. Pullen & Co.	53F-271	2 pgs.
	3. The North-western Bank	53F-272	2 pgs.
	4. David R. Johnston	53F-273	2 pgs.
	5. Smith W. Bagley	53F-274	2 pgs.
19. 12-11-79	Supplemental request by Collins, et	53F-285	8 pgs.

		al. for temporary allowance of claim for purpose of accepting or rejecting Plan		
20.	12-11-79	Supplemental request by Shelton, et al. for temporary allowance of claim for purpose of accepting or rejecting Plan	53F-286	3 pgs.
21.	1-15-80	Letter from Stahl of Steptoe & Johnson; re: substantial pleadings in representation of Collins, et al. and Shelton, et al.	53F-362	
22.	3-10-80	Descriptive index to briefs & matters filed on behalf of Collins & Shelton, et al.		4 pgs.
23.	3-10-80	Desig, of record relevant to issues identified by the Court		6 pgs.

24.	3-17-80	Written statement by Shelton, Suddeth & Fulk of grounds for objection to secured status of American Bank & Trust Co.	53F-400	6 pgs.
25.	3-17-80	Written statement by Collins, et al. of grounds for objection to secured status of American Bank & Trust Co.	53F-401	6 pgs.
26.	4-14-80	Comprehensive posthearing reply brief by Shelton, et al.	c/53F-412	49 pgs.
27.	4-14-80	Comprehensive posthearing reply brief by Collins, et al.	c/53F-411	49 pgs.

In addition to the above 27 filings consisting of a total of 392 pages, Steptoe has presented to this Court hundreds of other pages of material relating to but not filed in this proceeding. In open Court Steptoe indicated that already

the legal fees in connection with lawsuits in the District Court and the Bankruptcy Court so far would amount to $750,000 to $1,000,000. (As of the date of this Opinion, both class actions brought by Steptoe and Blackwell have not been certified in the United States District Court as class actions.) The Steptoe and Blackwell attorneys have attended 10 to 12 days of hearing in this Court on the plan and the confirmation of the plan as hereinabove mentioned as well as two or three appearances on the matters being decided in this Opinion. After hearing Steptoe in Court and considering all documents filed and presented to this Court for consideration, it is the conclusion of this Court that the so-called class claims and actions by Collins and Shelton-Fulk which are the basis of the alleged claims before this

Court are being pursued for the benefit of the attorneys rather than for the benefit of their so-called plaintiffs and clients. Many of these filings are considered by this Court to be frivilous and certainly not necessary or appropriate to promote and benefit the cause of their clients. Furthermore, it is the conclusion of this Court that the named representative class claimants are no more than "straw claimants" and these claims are made on behalf of the attorneys, not a valid, certifiable group of class claimants.

A question of conflict of interest has also been raised as to whether the Steptoe law firm's representation of the two different and competing class claimants is a conflict of interest in these bankruptcy proceedings. Since the applications and

class claims are being denied by this Court, it is not necessary to make a determination on that question at this time.

It is found by this Court that it would be unfair, inequitable and unjust to allow the Collins shareholders' class claim and the Shelton-Fulk employees' class claim to be filed against the debtor estate for the following reasons:

1. Fraud was alleged in the 1977 stockholder class action (Shaffner) which these class claims are based on. The normal procedure would have been to file a claim against the debtor corporation and ask that the prior settled case be re-opened and the matter liquidated in the District Court. This would have made the debtor corporation a defendant. (Steptoe and Blackwell were the attorneys in this

1973 suit in which they received a fee of $250,000.) However, instead of making the debtor a party defendant, Steptoe "made friends" with and co-plaintiffs of the debtor and Trustee for the sole purpose of gaining benefits and aid from the debtor and Trustee by access to debtor files and information. Steptoe benefited from the co-plaintiff relationship as follows:

a. The costs in the Collins shareholder class action (in which the Trustee was a co-plaintiff) was being furnished by the Trustee on behalf of the debtor.

b. The cost of the Shelton-Fulk employee class action was provided by the Trustee, pursuant to Court Order even though the plaintiff was not a party. However, such approval by the Court has since been reversed. (See above.)

c. Most importantly, clients or party plaintiffs were furnished by the Trustee to Steptoe and Blackwell in both cases, especially the pension suit. All plaintiffs, except one, in the pension suit are employees of the debtor corporation.

d. Steptoe and Blackwell by joining the Trustee as co-plaintiff had access to all information, goodwill, and other advantages which the former defendant corporation, now plaintiff, could give.

2. The plaintiff's action for mismanagement of the corporation by former officers has been taken over and is now being controlled by Steptoe and Blackwell by reason of the joint lawsuit. In the Collins suit, the Trustee is claiming actual damages of approximately $10,000,000 on other grounds while the attorneys in control of the suit are asking for

$10,000,000 in actual damages arising out of claims asserted in the former Shaffner suit. In other words, Steptoe has taken over the civil lawsuits from the Trustee for all practical purposes.

It is clear to this Court that Steptoe and Blackwell are now attempting to turn against the Trustee and "bite the hand that financed them." Steptoe has now turned against the Trustee, co-plaintiff in the pending litigation in District Court, and made the Trustee a defendant now in the bankruptcy proceedings based on the exact same claim. In fact, the Trustee has been "boxed-in" by this recent development. It is difficult for the Trustee to deny that there is not a valid claim against the estate when at the same time he is contending that the directors, officers, and other parties who in the past represented

the debtor corporation are in fact liable. It is conceivable that this is the reason the Trustee filed a "feeble" reply to the applications filed by Steptoe for listing and recognition as class claimants in the bankruptcy proceeding.

In August, 1979 the Trustee filed a plan of reorganization in which an outside company would become the stockholder and owner of all the Washington Group subsidiaries except Mayberry. Extensive hearings were had on the plan before it was finally approved by this Court. The plan was submitted to creditors and stockholders for voting but was rejected by a sufficient number of stockholders. During these hearings it appeared that the stockholder equity was very "thin". In fact, the stockholder equity, without the consideration of the two class claims as

herein mentioned and without recognizing about $1,000,000 in other contested claims, would be less than $3,000,000. If these two class claims were to be recognized and were to be liquidated as class action claims, the estate would be insolvent. In order to comply with the strict priority rule there will have to be a determination of solvency which would require a liquidation of these claims, if allowed, before a plan could be filed again. Due to economic conditions and especially the present business conditions of these companies, it is imperative that a plan be formulated and presented in the near future. It would not be feasible to delay presentation of a plan for possibly years in order to have a determination of class claims of this type. The rights and benefits of other creditors, including

existing stockholders, should not be jeopardized by diliatory actions and the selection of a wrong remedy by Steptoe. Steptoe, on behalf of its class clients, elected to pursue a remedy in Federal District Court whereby the corporation through its representative, the Trustee, was joined as a co-plaintiff. The theory of the election to sue the officers individually and join the debtor as a co-plaintiff is that the officers and directors were acting outside of their scope of employment and responsibilities as officers and directors. Steptoe (on behalf of its clients) cannot now come into Bankruptcy Court and choose a completely inconsistent remedy by now seeking to made the co-plaintiff in District Court a defendant in Bankruptcy Court. The theory of proceeding in Bankruptcy Court

and making the debtor corporation a defendant along with the officers and directors is that the officers and directors in fact acted within their scope of employment as officers. The class claimants should not be allowed to pursue both theories at the same time in different Courts because these two avenues of remedy are entirely inconsistent.

Under considerations of fair play and equity, both applications to become listed class creditors and be recognized as class claimants should be denied. The Bankruptcy Act deals with classes of creditors but not class action claims. There are no provisions for class actions and filing of class claims in the Bankruptcy Court under the Bankruptcy Act. Even if there were such provisions, these class groups have already chosen their avenue and should not

be allowed at this time to file and thus delay any feasible plan for years to come. The cost to the debtor would be astronomical and totally unfeasible.

Steptoe and Blackwell under the names of the Collins and Shelton-Fulk parties have also filed objections to the allowance of the claims of American Bank & Trust Company of Pa., A. M. Pullen & Co., The Northwestern Bank, David R. Johnston, and Smith W. Bagley in this Court. These creditors are already defendants in the Steptoe cases as now pending in the United States District Court. Since the Steptoe and Blackwell clients are not recognized as creditors or stockholders in these proceedings, they have no standing to object to these creditors' claims and such objections should be dismissed.

Let an Order be entered pursuant to this Memorandum Opinion denying the application and claims of the parties and dismissing the objections to the claims for reasons herein stated.

This the 15th day of May, 1980.

RUFUS W. REYNOLDS
U. S. BANKRUPTCY JUDGE

APPENDIX B

29 U.S.C. §1031 provides:

Repeal and effective date

(a)(1) The Welfare and Pension Plans Disclosure Act is repealed except that such Act shall continue to apply to any conduct and events which occurred before the effective date of this part.

(2)(A) Section 664 of Title 18 is amended by striking out "any such plan subject to the provisions of the Welfare and Pension Plans Disclosure Act" and inserting in lieu thereof "any employee benefit plan subject to any provision of title I of the Employee Retirement Income Security Act of 1974".

(B)(i) Section 1027 of such Title 18 is amended by striking out "Welfare and Pension Plans Disclosure Act" and inserting in lieu thereof "title I of

the Employee Retirement Income Security Act of 1974", and by striking out "Act" each place it appears and inserting in lieu thereof "title".

(ii) The heading for such section is amended by striking out "Welfare and Pension Plans Disclosure Act" and inserting in lieu thereof "Employee Retirement Income Security Act of 1974".

(iii) The table of sections of chapter 47 of such Title 18 is amended by striking out "Welfare and Pension Plans Disclosure Act" in the item relating to section 1027 and inserting in lieu thereof "Employee Retirement Income Security Act of 1974".

(C) Section 1954 of such Title 18 is amended by striking out "any plan subject to the provisions of the Welfare and Pension Plans Disclosure Act as

amended" and inserting in lieu thereof "any employee welfare benefit plan or employee pension benefit plan, respectively, subject to any provision of title I of the Employee Retirement Income Security Act of 1974"; and by striking out "sections 3(3) and 5(b)(1) and (2) of the Welfare and Pension Plans Disclosure Act, as amended" and inserting in lieu thereof "sections 3(4) and (3)(16) of the Employee Retirement Income Security Act of 1974".

(D) Section 211 of the Labor-Management Reporting and Disclosure Act of 1959 (section 441 of this title) is amended by striking out "Welfare and Pension Plans Disclosure Act" and inserting in lieu thereof "Employee Retirement Income Security Act of 1974".

(b)(1) Except as provided in paragraph (2), this part (including the amendments and repeals made by subsection (a) of this section) shall take effect on January 1, 1975.

(2) In the case of a plan which has a plan year which begins before January 1, 1975, and ends after December 31, 1974, the Secretary may postpone by regulation the effective date of the repeal of any provision of the Welfare and Pension Plans Disclosure Act (and of any amendment made by subsection (a)(2) of this section) and the effective date of any provision of this part, until the beginning of the first plan year of such plan which begins after January 1, 1975.

(c) The provisions of this subchapter authorizing the Secretary to promulgate regulations shall take effect on September 2, 1974.

* * * *

29 U.S.C. §1137(b) provides:

No employee of the Department of Labor or the Department of the Treasury shall administer or enforce this subchapter or the Internal Revenue Code of 1954 with respect to any employee benefit plan under which he is a participant or beneficiary, any employee organization of which he is a member, or any employer organization in which he has an interest. This subsection does not apply to an employee benefit plan which covers only employees of the United States.

* * * *

29 U.S.C. §1144(d) provides:

Nothing in this subchapter shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided

in sections 1031 and 1137(b) of this title) or any rule or regulation issued under any such law.

No. 80-1754

Office-Supreme Court, U.S.
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JUN 2 1981
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

WEBSTER A. COLLINS, HERBERT R. MORRISON, HELEN O. MORRISON, and GLEN A. WILKINSON,
Petitioners,

v.

DAVID R. JOHNSTON, THE NORTHWESTERN BANK, and JAMES R. GILLEY,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

PETITIONERS' REPLY MEMORANDUM

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TABLE OF AUTHORITIES

Cases	Page
Dana v. *SEC*, 125 F.2d 542 (2d Cir. 1942)	2
In re Duplan Corp., 450 F. Supp. 790 (S.D.N.Y. 1978)	3
In re S. Jersey Land Corp., 361 F.2d 610 (3d Cir. 1966)	2
In re Wonderbowl, Inc., 515 F.2d 18 (9th Cir.), *cert. denied*, 423 U.S. 869 (1975)	3, 4
Young v. *Higbee Co.*, 324 U.S. 204 (1945)	2
Statutes and Regulations	
11 U.S.C. § 506(1), (4) (1976)	3
11 U.S.C. § 606 (1976)	2
Miscellaneous	
6 *Collier on Bankruptcy* (14th ed. 1978)	2, 3

IN THE

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PETITIONERS' REPLY MEMORANDUM

I. RESPONDENTS' CHALLENGE TO THE STANDING OF THE PETITIONERS IS UNSOUND

A new issue raised in respondents' opposing brief in No. 80-1754 concerns the standing of investors to petition this Court for a writ of certiorari. *See* Respondents' Brief at 21-27. Briefly summarized, respondents' argument is that the investors were not parties to the reorganization proceedings and were not aggrieved by the lower court's reversal of the bankruptcy court's order authorizing the trustee to pay the costs of their

litigation. This argument is based on a fundamental misunderstanding, *inter alia*, of the nature of Chapter X reorganization proceedings, as distinguished from regular bankruptcy proceedings.[1]

In a proceeding arising under Chapter X, "[t]he debtor, the indenture trustees, and *any creditor or stockholder of the debtor shall have the right to be heard on all matters* . . . ." 11 U.S.C. § 606 (1976) (emphasis added). This Court has stated that this provision creates an exception to the general rules pertaining to standing to be heard and to appeal in bankruptcy cases: "[Section] 206 of the Chandler Act . . . , contrary to the general bankruptcy procedure, grants any stockholder or creditor the right to be heard on all matters relating to corporate reorganizations. Courts have liberally construed this language as authorizing appeals." *Young* v. *Higbee Co.*, 324 U.S. 204, 210 (1945) (footnote omitted).[2]

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[1] None of the decisions cited by respondents in their argument on the standing issue involves proceedings under Chapter X. In fact, at least one of respondents' authorities comments upon the significant difference between Chapter X and other bankruptcy proceedings in the area of standing to appeal. 6 *Collier on Bankruptcy* Part 2 ¶ 9.23[2], at 1700-01 (14th ed. 1978).

[2] One of the decisions cited with approval by this Court in *Young* v. *Higbee Co.* held that shareholders and creditors need not intervene in the district court in order to have standing to appeal to the circuit court of appeals. Dana v. SEC, 125 F.2d 542, 543 (2d Cir. 1942) (per curiam) (panel of L. Hand, Chase and Clark, JJ.). Rather, creditors and stockholders may appeal from any order deciding any matter in a Chapter X proceeding. *Id.* In a subsequent decision, the Third Circuit held that a creditor who made no appearance at the hearing before the district court pertaining to an alleged fraudulent transfer of the debtor's property to that creditor nevertheless had standing to appeal the district court's order requiring it to reconvey the property to the debtor. *In re* S. Jersey Land Corp., 361 F.2d 610, 614 (3d Cir. 1966). The law on this point was recently summarized by Judge Duffy of the Southern District of New York as follows: "'[T]he right to be

As a result of section 206, creditors and stockholders "are by statute parties to the case." 6 *Collier on Bankruptcy* Part 2 ¶ 9.23[1], at 1694 (14th ed. 1978). The record clearly establishes that petitioners are stockholders and creditors[3] of the debtors herein. For purposes of Chapter X, the term "creditor" is simply defined as "the holder of any claim." 11 U.S.C. § 506(4) (1976). The term "claims" is defined to include "all claims of whatever character . . . whether or not such claims are provable under section 103 of this title and whether secured or unsecured, liquidated or unliquidated, fixed or contingent." *Id.* § 506(1).

As creditors and stockholders of the debtors, the defrauded investors have the same statutorily protected interest in the order in question as do respondents. In fact, all creditors and stockholders of the debtors have a very clear interest in the issues presented. If the bankruptcy judge's January 16 order is upheld, the trustee's expenditure of the debtors' funds for costs of the *Gilbert* action is likely to result in a substantial reduction or elimination of the claims against the estate, as well as a substantial improvement in the viability of any plan of reorganization, and the prospects for financial recovery by all creditors and stockholders will therefore be greatly enhanced.[4] Therefore, the respondents'

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heard' provided for in Section 206 and Rule 10-210(a)(1) includes the right of appeal even absent participation in the proceeding resulting in the order from which the appeal is taken." *In re* Duplan Corp., 450 F. Supp. 790, 792 (S.D.N.Y. 1978).

[3] The class plaintiffs' claims in *Gilbert* against the debtors' directors, officers and agents could also be claims against the debtors themselves. Indeed, the petitioners herein filed proofs of claims in the reorganization proceedings on September 14, 1979. Respondents' Brief at 13.

[4] Far less substantial interests have been held to confer standing to appeal orders in reorganization proceedings. *See, e.g., In re Wonderbowl, Inc.*, 515 F.2d 18, 19 (9th Cir.) (stockholder

assertion that the defrauded investors "have no rights to seek this review" is without merit.

II. RESPONDENTS RELY UPON A DECISION OF THE BANKRUPTCY COURT WHICH HAS BEEN REVERSED ON APPEAL

Respondents have cited and appended to their opposing brief the entire text of an opinion written by the bankruptcy judge on May 15, 1980, which purported to disallow the claims filed in the Chapter X proceedings by petitioners. Respondents failed to report, however, that upon appeal by the petitioners and the United States Securities and Exchange Commission, the district court has upheld petitioners' right to file claims in the Chapter X proceedings and reversed the bankruptcy judge's disallowance of those claims. Memorandum dated May 18, 1981.[5] Respondents also failed to disclose that the bankruptcy judge's May 15, 1980 order did not alter or rescind his January 16, 1979 order which is the subject of this petition. *See* Petition at 24a. Thus, the bankruptcy judge's now-reversed opinion and the unfounded statements contained therein should have no bearing on this Court's decision to grant certiorari in this case.

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whose subordinated position renders his stock worthless nevertheless has standing to appeal order approving compromise in Chapter X proceeding), *cert. denied*, 423 U.S. 869 (1975).

[5] Attached hereto as Appendix A. This memorandum was transmitted to counsel by the clerk of the district court on May 19, 1981, but counsel have previously been advised by the district court, on several occasions, that it intended to reverse the bankruptcy judge on this issue.

Respectfully submitted,

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June 1981

APPENDIX A

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF NORTH CAROLINA
OFFICE OF THE CLERK

Post Office Box V-1

Greensboro, North Carolina 27402

CARMON J. STUART, Clerk

Telephone (919) 378-5347

May 19, 1981

TO: ALL COUNSEL OF RECORD

RE: C-80-342-G; Shelton and Collins, et al. v. Gilbert, et al.
(B-77-695 etc. Appeal)

Gentlemen:

Please see the attached memorandum dated May 18, 1981, of Judge Erwin's ruling on the appeals from the Bankruptcy Court Order dated May 15, 1980.

Your proposed judgment should be submitted to this office no later than *June 8* for coordination and forwarding to Judge Erwin.

Very truly yours,

/s/ Carmon J. Stuart
CARMON J. STUART

bf

Enclosure

UNITED STATES GOVERNMENT

memorandum

Date: May 18, 1981

/s/ Richard C. Erwin

Reply to
Attn of: Richard C. Erwin, U.S. District Judge

Subject: C-80-342-G; Shelton and Collins, et al. v. Gilbert, et al. (Appeal B-77-695 etc.)

To: Mr. Carmon J. Stuart
Clerk of Court

The Court is ruling as follows on the above-referenced appeal from the May 15, 1980 order of Judge Reynolds, Bankruptcy Judge:

(1) As to the Collins, et al. claim (filed September 14, 1979):

a. Reverse Judge Reynolds as to Webster A. Collins, Herbert R. Morrison and Helen O. Morrison, W. O. Gregory, and Glen A. Wilkinson.

b. Affirm as to "[Names and addresses of all other similarly situated shareholders of the Debtors known to or reasonably ascertainable by the Trustee]."

(2) As to the Shelton, et al. claim (filed September 14, 1979):

a. Reverse Judge Reynolds as to Thomas W. Shelton, William F. Suddeth, and George W. Fulk.

b. Affirm as to "[Names and addresses of all other similarly situated employees and for-

mer employees of the Debtors known to or ascertainable by the Trustee]," *but* remand to Judge Reynolds with instructions that he consider the Proof of Multiple Claims filed October 5, 1979 by George W. Fulk in his capacity as fiduciary with respect to various profit sharing, pension, and retirement plans listed in the claim.

(3) The Court requests that all parties file a proposed judgment within twenty (20) days of this date in light of the above.

see 80

1755